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Author:
Miller, Franklin & Company
Title:
How to audit

Place:
New York
Date:
1930

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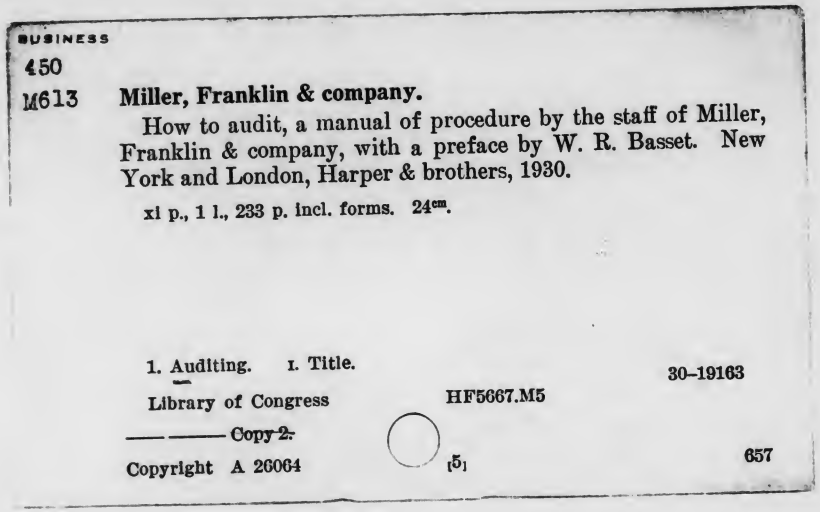

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HOW TO AUDIT

A MANUAL OF PROCEDURE

MILLER, FRANKLIN & COMPANY

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HOW TO AUDIT

A Manual of Procedure

HOW TO AUDIT

A Manual of Procedure

BY

THE STAFF OF

MILLER, FRANKLIN & COMPANY

WITH A PREFACE BY

W. R. BASSET

HARPER & BROTHERS PUBLISHERS

NEW YORK AND LONDON

1930

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FOREWORD

It is taken for granted that those who use this book have a sound fundamental knowledge of accounting and the theory of solving its many intricate problems. Therefore, no attempt is made to illustrate the solution of any hypothetical problems. The book is intended to be a general guide for making an audit examination. It describes recognized audit procedure, accepted methods of obtaining information necessary thereto, and completed audit reports for various types of business based on the form for financial examinations recommended by the Federal Reserve Bank and methods found satisfactory from a practical standpoint.

PREFACE

THIS book should be valuable to auditors, not merely because it is a comprehensive and detailed description of the multitudinous steps to be taken in auditing businesses of various kinds, but because it suggests to the auditor how to look behind the detailed figures.

The auditor who confines himself to the mere routine of checking and adding columns of figures is little more than a machine. The truly worthwhile auditor is the one who can interpret figures and statements intelligently.

Mere routine, unthinking auditing by a man who does not have the broader vision and who is unable to see behind the figures, has many times permitted unsound conditions or methods, and sometimes even defalcations, to continue year after year.

A case of this came to light not long ago in a company which had been submitted to several periodical audits by a nationally known firm of auditors, whose representatives, however, unfortunately failed to possess the ability to look behind the figures.

For some reason or other a new firm of auditors was employed. The men in charge were accustomed to look upon an audit from a broader point of view. It was, therefore, almost a matter of course for them to be suspicious of the fact that this company was a very heavy borrower at the banks in spite of the fact that it generally had several millions of dollars on deposit. The auditors could not reconcile this anomalous situation in spite of the fact that the routine audit

showed nothing wrong. In each case the banks had certified that the company had the money on deposit. Ordinarily that was all the assurance that auditors would need that everything was all right, and the ordinary auditor would undoubtedly attribute heavy borrowing by a concern with large balances to merely a strange idiosyncrasy of the management.

These auditors, however, were not so easily satisfied. They dug deeply into every phase of the company's business and analyzed the figures which their audit had brought forth. They finally discovered that the company had, through long practice and the possession of good credit, succeeded in getting the banks to credit it with deposits immediately upon the deposit being made. That is to say, it received credit for checks before the banks had collected them. The company operated many branches and certain of the checks which it deposited were checks of distant branch banks.

By carefully drawing certain transfer checks and depositing them on the last days of the year, it received credit for large sums in its home banks and continued to receive credit for the same sums in distant branch banks to whom transfer checks would not be reported until several days of the new year had passed. In short, bank statements certified to the existence of the same cash in both banks.

Under cover of this financial jugglery, the treasurer had been robbing his company for several years. His total defalcation was in excess of a million dollars. Had his accounts continued to be audited by unthinking routine accountants, he would probably still be holding the treasurer's job. It took a firm of broad-visioned and thoughtful auditors to dig out the facts which put him behind prison bars.

With the development of big business and especially of mergers whose offices are spread out over the nation, it is becoming almost impossible for auditors to examine all transactions in detail. About all that the outside auditor can do today is to audit the treasurer's office as a whole and test out the various subsidiary figures in order to determine their accuracy. For that reason, it is becoming more and more essential that audits be performed by men who back up their technical audit knowledge with the ability to reason and to draw accurate deductions from their observations.

I may add that this conviction has been borne in upon me not only in my capacity as an investment banker, but from many years experience as a certified public accountant.

William R. Basset

Section I

GENERAL INSTRUCTIONS

CHAPTER I

General Instructions for a Statement of Condition Audit of a Manufacturing or Merchandising Concern

Before commencing an examination each auditor should be provided with an Examination Program similar to that shown in Figures 1, 2, 3, 4, on pages 4 to 11 inclusive.

The history of an examination should be accurately recorded on the program in complete detail. Any analysis of accounts not provided for on the form should be suitably designated under its proper caption. This program, printed on heavy paper, also constitutes a cover in which the work papers are bound, as described on pages 96 to 99 inclusive. It is to be turned in to the office along with the manuscript of the report.

If preliminary work is done, and the examination then discontinued, or postponed, the program and work papers should be returned to the office to be filed under the client's name as "work papers." They will then be delivered to the accountant or to his successor, when the examination is resumed. Particular care should be taken to show on the program the point to which work has been carried, so that, if an accountant other than the original examiner continues the work, the same ground will not be covered twice.

The following instructions are a combination of the form for financial examination recommended by the Federal Reserve Bank, and accepted methods which have been generally found to be satisfactory. The terms "balance sheet" and "statement of condition," which are both used by accountants, are inter-

changeable. However, as "balance sheet," as a title of the statement, has to recommend it only the fact that custom has established the term, the use of "statement of condition" is preferred as more truly expressing the statement's intent. Similarly, "statement of operations" is preferred to "income and profit and loss account," or "profit and loss account," when giving a title to the detailed statement which shows the way of arriving at the profit for the period under review.

A Statement of Condition audit for a fiscal year or other operating period of an industrial or mercantile corporation or firm comprises a verification of the assets and liabilities, a general examination of the Profit and Loss account, and a thorough analysis of the Surplus account to ascertain whether it is earned surplus, or capital surplus. Incidentally, an examination of the essential features of the accounting methods should be made.

Trial balances of the general ledger, both at the beginning and at the end of the period under review, should be prepared in comparative form, and checked with the ledger. The items in the trial balances should be traced into the Statements of Condition before the assets and liabilities are verified, to prove among other things, that no contra-asset or liability has been omitted from the accounts, that the assets and liabilities have been grouped in the same manner at the beginning and at the end of the period, and that the Statements of Condition are in accordance with the books. The disposition of any general ledger assets and liabilities that may have been scrapped, sold, written off, or liquidated during the period under review should be traced and noted in the work papers. Furthermore, a general scrutiny of the general ledger should be made to make sure that no accounts that have been opened and closed during the year, have any bearing on the company's financial position at the close of the fiscal period.

The auditor should obtain a copy of the Statements of Condition at the beginning and the end of the period to be audited, and should make a comparison between them, so that a comprehensive view may be had by him of the changes in the figures during the period under review. A statement of the disposition of the profits should then be prepared from this comparative Statement of Condition as a further aid in impressing the meaning of the figures upon the mind of the auditor.

In setting up a comparative Statement of Condition, put the latest date first unless the client prefers the reverse.

The verification of assets and liabilities will for convenience be considered in the order in which the items appear in the Statement of Condition form shown as Figures 12 and 13 on pages 76 to 78. This form of statement aims to meet as nearly as possible the requirements and practice of the Federal Reserve Bank.

FIG. 1

EXAMINATION PROGRAM

Client's Name .....

Address .....

Report for the period—from .....*to* .....

The Work Papers of an audit or investigation form an important part of the work. They should be neatly prepared and carefully kept. They should show a complete detail of all items in the accounts that have been examined, and should indicate (a) methods of verification used; (b) questions brought up during the examination, the disposal thereof, and name of the representative authorizing any arbitrary handling of the accounts.

Where conditions arise that vitally effect an audit from year to year, and where work done is likely to become, or already is, a regular audit, the Senior in charge should separate from the work papers all documents of recurring utility, such as copies of certificates of incorporation, trust deeds, long term contracts or agreements, and abstracts of the minutes, etc. Such papers should be separately bound and plainly marked "Permanent File" and placed in the current file.

This form is to be used as the outside cover for the Work Papers which are to be assembled, under the direction of the Senior, in the following order.

1. Index to Work Papers.
2. Trial Balance.
3. Adjusting Journal Entries.
4. Schedules, Analyses, and Notes, in trial balance sheet order.
5. General Remarks and Notes.

All Work Papers are to be arranged in the order in which the subject appears on the Trial Balance Sheet, and each page is to be numbered at the bottom of the sheet. An index is then to be prepared listing each sheet, or group of sheets comprising a subject, the index to give the page numbers. This index is to be placed first as noted above.

All adjusting journal entries shall be numbered, and a corresponding number shown after each item on the Trial Balance Sheet for which an adjustment is made. The number on the Trial Balance Sheet is to be "circled" to prevent any misinterpretation of figures, and as a means of ready reference.

After Work Papers have been properly arranged they are to be carefully fastened together with fasteners and placed in the envelope provided for that purpose, together with the Manuscript of the report itself, which is to be typed or printed. Any notes or memoranda too small to be properly fastened should be pasted to a work paper sheet and the sheet then properly inserted in the cover.

Write plainly.

Property to be examined .....

Address .....

Work to start .....

Supervising Accountant must turn report in to office by .....

Days estimated.....*Senior*.....*Junior* .....

Accountants assigned .....*As Seniors* .....

.....*As Juniors* .....

Work to be undertaken is indicated by check mark in column headed "Do" .....

Read your "Staff Instruction Book" carefully for procedure on various points checked

FIG. 2

	DO	DONE BY			
1. PLANT AND EQUIPMENT:					
A. Based on appraisal?					
B. Examine additions. Are they at cost?					
C. Properly depreciated?					
D. Titles to property examined?					
E.					
F.					
2. GOODWILL:					
A. How created?					
B.					
C.					
3. TREASURY HOLDINGS:					
A. Physically examined?					
B.					
4. SECURITIES OWNED:					
A. Physically examined?					
B. Correspond with holders outside of office					
C. Appraise					
D. Pledged as collateral or otherwise					
5. SINKING FUND:					
A. Being properly set aside?					
B. Properly applied in retiring securities?					
C.					
D.					
6. INVENTORY:					
A. Count quantities					
B. Examine method of compiling costs used					
C. Multiply extensions					
D. Verify additions					
E. Should inventory be depreciated?					
F. Have all materials included in inventory been paid for or have vendors been credited?					

G. Scrutinize inventory beginning of period to prove operating statement accuracy					
H. Verify consigned goods by correspondence					
I. Consigned goods carried at cost					
J.					
K.					
L.					
M.					
7. CASH:					
A. Reconcile cash and check books with bank statement					
B. Secure certificate of balance from bank					
C. Deposit checks found in drawer, in bank, requesting advice of protest					
D. Count cash on hand					
E. Have an executive approve I.O.U.'s due bills, advances, etc. on hand					
F. Check checks to cash book examining signatures and endorsements					
F.					
G. Add Dr. cash book					
G.					
H. Add Cr. cash book					
H.					
I. Examine vouchers for check disbursements					
I.					
J. Examine vouchers for petty cash disbursements					
J.					
K. Post cash book to ledger					
K.					
L. Add payroll					
L.					
L.					
M. Extend payroll					
M.					
N. Post payroll totals to entry into general books					
O.					
P.					
Q.					
R.					
S.					
T.					

FIG. 3

	DO	DONE BY			
8. ACCOUNTS RECEIVABLE:					
A. List with name } Prove with					
B. List by age with name } controlling account {					
C. List by machine } if one exists					
D. Correspond with debtors to verify					
D.					
D.					
E. Check replies from debtors					
E.					
E.					
E.					
F. Add sales book					
F.					
G. Post sales book footings to general books					
H. Analyze sales					
H.					
I. Have credit allowances approved by executives					
J. List credit balances separately					
K. Have any accounts been pledged to secure loans?					
L. Take out consignment accounts					
M. List past due accounts and comment on presumably uncollectible accounts					
N.					
O.					
P.					
Q.					
R.					
S.					
T.					
U.					
9. NOTES RECEIVABLE:					
A. List with particulars					

B. Correspond with holders of notes outside of office					
C. Verify by corresponding with makers					
D. Have executive approve notes charged off					
E.					
F.					
G.					
10. DEFERRED AND ACCRUED ITEMS:					
A. Figure prepaid and accrued bond interest—separately					
B. " " " " Interest—separately					
C. " " or " Wages					
D. " " " " Taxes					
E. " " " " Rent					
F. " " " " Royalty					
G.					
H.					
I.					
J.					
K.					
L.					
11. ADVANCES:					
A. If large advances have been made to subsidiary concerns, investigate solvency of subsidiary concerns or comment on fact					
12. CAPITAL STOCK:					
A. Examine minutes for disbursement authority, dividends, etc.					
B. List stockholders from stock ledger					
C. Check stock transfers and postings to ledger					
D. Examine cancelled certificates for endorsement, cancellation, etc.					
E. Prove stubs of outstanding certificates with the total aggregate stock outstanding					
F.					
G.					
H.					
I.					
J.					

FIG. 4

	DO	DONE BY			
13. BONDS, MORTGAGES, ETC.:					
A. Examine county records for mortgages on property					
B. Examine and aggregate paid bond coupons					
C. Secure certificate from trustee of mortgage on which bonds are issued, or, outstanding, retired bonds, etc					
D.					
E.					
14. ACCOUNTS PAYABLE:					
A. List with name / B. List by age with name / C. List by machine — Prove with controlling account if one exists					
D. Correspond with creditors to verify					
D.					
E. Check answers from creditors					
E.					
F. Examine inventory to ascertain if assets are represented by liability for unpaid bills					
G. Add book of original entry of bills					
H. Check postings to general books					
I. Analyze distribution of purchases and expenses					
J. Make record of extravagances					
K.					
L.					
M.					
15. NOTES AND LOANS PAYABLE:					
A. List each separately with details					
B. Ascertain if contingent liability exists					
C. Correspond to ascertain if amounts shown cover entire indebtedness					

D.					
E.					
F.					
G.					
16. GENERAL:					
A. Is sufficient insurance carried?					
B. Any unclaimed wages on hand?					
C. Any cumulative dividends not shown?					
D. Any profit sharing arrangement not shown?					
E. Add general ledger accounts					
F.					
G.					
H.					
I.					
17. SPECIAL, BANK, INSURANCE COMPANY, ETC., EXAMINATIONS:					
18. TAX:					
A. Prepare federal report					
B. Prepare state report					
C.					

CHAPTER II

Current Assets

Cash.—Cash on hand should be counted after banking hours on the last day of the fiscal period to be covered by the audit, and the amount of it, together with the amount of cash stated to be in the bank, reconciled with the balance shown by the cash book.

The cash, notes receivable, and investments must be examined on the same day, so as to make it impossible for anyone to make up a shortage in one asset by temporarily withdrawing negotiable funds from another.

In counting the cash on hand, the auditor must see that all customers' checks produced to him as a part of the cash balance have been duly entered in the cash book prior to the close of the period. He should note the dates and descriptions of such checks, and also the dates and descriptions of all advances made from cash which are not recorded on the books.

Certificates, in the form shown as Figure 5 on page 13, certifying to the cash on deposit on the evening of the closing date must be obtained from the client's banks. Banks with branch offices do not, as a rule, maintain a branch office customers' list; therefore, to avoid delay and possible requests for additional information by the bank, all requests for bank verifications should be mailed direct to the branch at which the client's account is kept. The verifications must be secured by the auditor in person or mailed to him at his home office. A stamped, self-addressed envelope should be enclosed for

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....19....

.....
.....

Dear Sirs:

We are engaged upon an audit of the accounts of .....and it appears that (at the close of business) on.....19.... there was on deposit with you to his / their credit the sum of $.....

Will you kindly advise us direct whether the aforesaid balance is correct.

Very truly yours,

.....

By .....

Please furnish the above information as requested.

.....

.....19....

(Name)

.....

Dear Sirs:

This is to certify that there was on deposit in this bank (at the close of business) on .....19.... to the credit of ..... the sum of .....dollars.

$.....

.....

By .....

FIG. 5

that purpose. The balances as shown by the certificates of balance must be reconciled with those shown on the cash book, the check-book stubs, or bank registers, taking into consideration outstanding checks. The fundamental purpose of a bank reconciliation is not so much the actual verification of the bank balance itself, as to determine differences that may exist, and which need to be fully investigated.

In verifying the outstanding checks the only sure and satisfactory way to prove their accuracy is to compare the credit side of the cash book from the last day of the fiscal period backward, item by item, with the checks returned from the bank for such period as may be necessary to account for all current outstandings. Any old checks not yet cashed by banks should be made the subject of special inquiry. When this comparison and investigation is completed, a list of the outstanding checks should be prepared, showing the dates, payees, and amounts. This list should be compared with the actual checks returned from the bank at a later date, and any not returned should be specially investigated. Checks may be outstanding as a result of disputed amount, a duplicate payment may be involved and check held for investigation, or occasionally a check may be actually lost.

Outstanding checks not examined at a previous audit on account of not having been returned by the banks must be called for and traced into the cash book at the beginning of the current audit.

Special care is necessary to see that no checks for cash purposes are drawn at the close of the period and entered in the next period.

If the currency and bank transactions are kept together in the cash book, and the auditor does not count the cash until a date subsequent to the close of the fiscal year, he must, in addition to verifying the bank balances as of the close of the

year, verify them as of the date of the count of cash. This is absolutely essential because, although the cash on hand which forms only part of the balance at the date of the count may be correct, it does not follow that the total cash is correct. It is essential that the date upon which the cash is counted should be recorded, in event of a discrepancy arising after the departure of the auditor.

The auditor should make certain when calling for cash on hand that the funds awaiting deposit are included in the cash to be counted. Failure to take such precaution might later lead to the discovery of other funds on hand at the time cash was being counted, in which event the accuracy of the account might prove questionable. Funds awaiting deposit should be counted either at the close or the beginning of the business day, and suitable action taken to keep these funds intact for deposit. It may even be found desirable to seal the cash items composing the deposit in order to keep them separate from later receipts. Whatever method is pursued in accounting for the funds not yet deposited the auditor must be certain that no opportunity is afforded for double counting, or substitution of funds.

Unfortunately, it is not usually possible to verify cash by being present on the last day of the period being investigated. So many companies close their books on December 31, that it becomes physically impossible to visit all clients on that day. However, the method described in the preceding paragraph is the one generally to be followed.

When the receipts are shown in the cash books as being deposited in the bank on the last day of the fiscal period, but are included in the reconciliation statement on account of their not being paid into the bank until the next day, the auditor should ask the banks to acknowledge the later receipt of the deposit, and to advise if any of the checks prove worthless.

The deposits shown in the pass books, or upon the banks' monthly statements, should be checked in detail for the last two or three days of the fiscal period, from the books, to prove that they were composed of bona fide checks, and that no check drawn by the company was deposited in a bank without being credited to the bank on which it was drawn, prior to the close of the fiscal period.

So that the auditor may satisfy himself that deposits are promptly made in a bank each day, and that the checks deposited are the same as those received, it is advisable to call for a number of deposit slips and compare them with the receipts as shown by the cash book for the days on which the deposits are made. To make such verifications accurate, the deposit slips should be obtained from the banks.

The senior accountant must use his discretion as to the extent of the cash examination.

Where irregularities are suspected, the most thorough check must, of course, be obtained.

When it is the practice of a company to pay all of its cash receipts into the bank, they should be compared and reconciled with the total deposits as shown by the bank books, and similarly the disbursements should be reconciled with the total checks drawn.

The balance on hand in the petty cash fund should be represented by either cash or vouchers. All tickets, due bills, or advance memoranda should be presented to the proper authority for approval (an officer, if a corporation; a firm member, if a partnership). Checks carried as a part of the balance should be followed to a proof of their having been deposited in the bank or vouched for by the proper authority.

When making an accounting for the petty cash fund the auditor should, if possible, determine the reasonableness of the expenditures made from this fund. The various tickets,

due bills, or other memoranda should be carefully scrutinized. Due bills of large amount to any one person, or of small amount of long standing, should be given careful consideration, and where necessary inquiry made to determine that the petty cash account is actually involved and truly represents such funds. If there is any uncertainty the items should be brought to the attention of some one in authority.

Tickets and memoranda may be found to represent charges to other accounts, and require special handling.

The various items composing this fund should be listed in the work papers. Advances or I.O.U.'s should be listed individually and not in total.

Items which have required special investigation, assuming that any suspicion of irregularity exists, should be commented upon in the manuscript prepared for the client. In all cases where the cash items amount to a large sum the accountant should use his discretion as to whether they should be listed and included in the final report. The method described is intended to secure an absolute check, but to do so requires considerable research, not always justified or acceptable to clients.

If the auditor visits a branch office for the purpose of verifying branch office funds, the verification should be similar to the verification of a petty cash fund. If items are found representing disbursements on behalf of the main office, they should be traced to the main office records or confirmed by that office. Where it is not possible, or desirable, to visit the branch office a detail of the items composing such funds should be requested from some one in authority.

Occasionally, funds may be found to be in the custody of officers or employees. Verification of such funds will depend to a large extent upon the amount involved—a negligible fund needing only a letter of verification. Large funds should be

counted, if possible, or, if verified by letter, the verification should show in detail the items composing the fund. This detail should be satisfactory to the auditor, or accepted by some one in authority in the client's organization.

Cash on deposit in special funds for a particular purpose should not be included with the cash under current assets on the Statement of Condition, but shown separately. It is obvious that the cash in those funds is not readily available for current purposes, but may be used only for the purpose for which the fund was created. If funds so segregated are to be used as a sinking fund they should appear under that caption on the Statement of Condition. Further reference to sinking fund provisions will be found in Chapter 3.

Where cash is held in foreign countries its equivalent should be expressed in United States dollars at the rate of exchange as at the close of the date of audit. Differences between such value and book value should be adjusted.

The auditor should make a careful inspection of the records of cash in transit. If at all possible it should be counted at the forwarding and the receiving office, or both.

In most of the audit examinations the auditor will find it necessary to obtain information respecting a client's liability to the depositary. For such additional information a form shown as Fig. 6—7 on pages 19 to 21 may be used.

Bank Overdraft.—Where a concern has several banks of deposit, and any bank account is overdrawn, the Statement of Condition should not show the net amount on deposit. Rather the total cash on deposit should be shown on the asset side of the statement, and the overdraft listed under current liabilities.

The extent of the examination of the cash records will depend largely upon the completeness of the internal system, and, of course, taking into consideration the scope of the audit

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....

.....

.....

You are respectfully requested to forward, at your earliest convenience, to the undersigned, the information asked for in this form.

This information is requested solely for the purpose of reconciling the account of the within-named with your bank at the date of examination.

An addressed and stamped envelope is enclosed for your reply.

Respectfully,

By.....

Please give the information requested:

.....

FIG. 6

EXAMINATION OF.....

Answers to the following questions are respectfully requested:	Number or Date of Remittance or Loan	Description of Bills, or Loans
1. Did your bank have under discount any bills receivable of the above named or any for which it was in any way liable? If so, please list in detail, marking such items "1" in "Remarks" column.		
2. Did your bank hold bills receivable or any securities belonging to the above named, or for which it was in any way liable? If any were held, please list and state how they were held, i.e., "Advances," "Loans," "Collection," "Safekeeping," or "Collateral."		
3. Were there any loans then outstanding by your bank to the above named, or to any other party for which the above named was in any way liable? If so, specify character of loan—whether upon bills payable, under Commercial Letters of Credit, upon Certificates of Deposit, Open Accounts, or otherwise. In each case specify amount, time, etc.		
4. Had your bank, at said date, effected any loans for account of the above named? If so, give names of borrowers and amounts, state how the notes were secured and whether or not the security was held by your bank.		
5. Please give details if any other actual or contingent liability of the above named to your bank.		

THE BALANCE DUE BY US TO THE ABOVE NAMED

REPLIES COMPLETED .....19....

FIG. 7

AS OF CLOSE OF BUSINESS.....19....

Securities	Maturity	Amount	Rate	Interest Paid to	Date of Next Coupon	Remarks

ON THE ABOVE DATE WAS $.....

(NAME OF BANK).....

(OFFICER) .....

desired. Depending upon the scope of the audit the auditor should use his discretion as to testing footings, the extent of examination of entries to determine that they are proper, giving due consideration to the neatness and accuracy of the cash book records in general. However, neatness should not be mistaken for accuracy nor accepted as a certain indication of it.

Notes and Trade Acceptances Receivable.—A list of notes receivable outstanding at the end of a fiscal period should be obtained from the client, unless there are but few notes on hand, in which case the auditor should prepare a list as the notes are examined or accounted for. The list of notes should show the date, the customers' name, the date due, the amount, and the interest rate. Notes receivable, properly listed, should be grouped or designated to show:

Notes on hand
Notes out for collection—not overdue
Notes discounted—not due
Notes in hands of attorneys or others—overdue.

The list of notes should be further subdivided to show:

Trade notes receivable
Other notes receivable.

If any of the notes bear the name of an indorser, that fact should be noted in the list and the name of the indorser shown. Occasionally payments are made on account of notes and the amount of the payment is recorded on the note itself, and should be deducted from the face of the note.

If notes are discounted, the name of the discounting bank should be noted and verification thereof obtained from the bank. The amount of notes discounted should be noted as a contingent liability on the Statement of Condition.

The oustanding notes must be carefully compared with the notes receivable record, and with the list prepared by the client or auditor, the due date, and the date of making being carefully checked. When notes have been renewed the original dates should be recorded. When notes have been paid since the close of the fiscal period, the cash should be traced into the books, and, when they are in the hands of attorneys or bankers for collection, letters of confirmation should be obtained from the depositaries certifying to that fact. If a considerable number of notes are out for collection, the auditor will furnish the bank, or other holders, a list of the notes shown to be held by them, and request that the list be examined and returned with a letter of confirmation or correction.

Overdue notes in the hands of attorneys or others for collection should be verified by correspondence with the holders, and the auditor should ask for a statement of the expected realization. Adequate provision should be made for anticipated losses.

The accrued or prepaid interest on notes receivable should be calculated by the auditor, or such tests made as will satisfy him of the accuracy of the calculations already made. Interest on overdue notes should not be included in the assets unless reasonable assurance is given that both the principal and the accrued interest will ultimately be collected.

The method of verifying trade acceptances is similar to that used in verifying notes receivable. Usually the amount of trade acceptances is included with that of notes receivable —trade. Occasionally, however, it may be found that trade acceptances should appear on the Statement of Condition as a separate item to portray more clearly the assets of the client.

The value of collateral, if any, held for notes should be ascertained, as it frequently happens that the notes are for a greater amount than the value of the collateral.

Notes due by officials and employees as well as those re-

ceived for other than trade transactions must always be stated separately from customers' notes.

Notes due from affiliated concerns must not be included as customers' notes, even though received as a result of trading transactions. Affiliated companies' notes should be shown as a separate item of current assets or as other assets, as the circumstances warrant. They may be fairly included in current assets, if the debtor company has ample margin of quick assets over its liabilities, including such notes.

The term "quick assets" is used here in the sense in which it is used in Federal Reserve practice. "Current assets" is used to designate those assets and other assets which, though current, are excluded in determining the eligibility of the paper for Federal Reserve purposes.

The best verification of Notes Receivable is an acknowledgment by the party named in each note as the payor that the note is a bona fide obligation. Therefore, if time permits, and the client does not object, it is advisable to obtain the maker's written confirmation for each note. The auditor should personally mail the letters, inclosing stamped envelopes for replies addressed direct to his home office.

Accounts Receivable.—The auditor must assume that every Statement of Condition may be used as a basis for obtaining a loan. Therefore, he should clearly designate the various accounts so as to show their real composition. The item of Accounts Receivable is frequently a catch-all. It sometimes includes amounts due from regular trade customers, advances to officers and employees, amounts due from affiliated companies, amounts due for deposits, guarantees, freight claims, and many other extraordinary items which have no connection whatever with the sales of the company. Advances to officers and employees, and amounts due from affiliated companies, to say nothing of other extraordinary

items frequently included in this account, are not, as a general rule, considered to be current assets by a bank or other creditor. Ordinarily a creditor will place such items below Current Assets on the Statement of Condition. The auditor should therefore be particular to separate Accounts Receivable into its component parts under their proper captions. While theories may differ as to the treatment of Accounts Receivable on the Statement of Condition in so far as reserves for doubtful accounts and discounts are involved, nevertheless, the set-up in Figure 12, on pages 76-77, will reflect the preferred segregation of the items in this account. The auditor must bear in mind that frequently customers' accounts are pledged, in which event a separation of the free and pledged amounts should be shown. An extraordinary item, if included under the caption of Accounts Receivable, should have a subdivision heading to denote the nature of the item.

The extent to which Accounts Receivable will be verified depends upon (1) the arrangement under which the examination is made, (2) the size and reputation of the client company, (3) the condition of the accounts, and (4) the system of internal check. Upon these points the auditor must satisfy himself at the beginning of the audit. In large concerns the system of accounting employed is generally such that it would be almost impossible for accounts to be paid and not correctly credited on the accounts receivable ledgers, but in small concerns, with imperfect systems, such occurrences are quite possible; so much so, in fact, that it is generally admitted that the risk of errors and omissions decreases in direct proportion to an increase in bookkeeping.

The best verification of an open balance is a confirmation by the customer; therefore, if time permits and the client does not object, it is advisable to circularize the customers with an inquiry form such as that shown as Figure 8, on

page 28. The auditor should personally see the circulars mailed after comparing them with the lists of outstanding accounts. The stamped envelopes for replies sent with the circulars should be addressed direct to the auditor's home office.

It occasionally occurs that a client will insist on preparing and sending out his own requests to customers for verification of the accounts receivable. In that event one of the forms shown in Figure 9, on page 29, may be used so that the customer will know the reason for the request.

The bookkeepers of the accounts receivable ledgers should be asked to draw off lists of the open balances at the end of the fiscal period, and distributions of the total columns should be shown on the lists according to the age of the accounts, e.g., not yet due, less than 30 days past due, and more than 30 days past due. When the term of credit is more than 30 days, age the accounts as (1) less than 30 days, (2) 30 to 60 days, (3) 60 to 90 days, (4) 90 days and over, etc. A notation of the unusual term of credit should appear on the statement of the aged accounts. In commenting on the age of accounts it is desirable that, whatever the term of credit, it be stated.

The accounts paid since the close of the fiscal period should be noted in the lists before taking up the matter of past due accounts with the credit department, as payment is of course the best proof that an account was good at the date of the audit.

The totals of the lists of outstanding accounts should agree with the control account in the general ledger if separate ledgers are kept.

It is not the auditor's duty to locate difference between the total of the customers' accounts and the control account. Call the client's attention to the difference and to the condition of the accounts in general. Subsequent arrangement may be made, unless included in the terms of the original engagement, whereby the auditor will undertake to bring the accounts into agreement.

When credit balances appear on customers' accounts they should be shown in the Statement of Condition as separate items and not deducted from the total of debit balances. Debit balances on the accounts payable ledgers should be treated in the same manner.

The lists must be footed and compared in detail with the customers' accounts in the ledgers.

The composition of outstanding balances should always be examined, as it frequently happens that, while a customer may be making regular payments on his account, old items are being carried forward which have been in dispute for a considerable period of time. Such items and accounts which are past due should be taken up with the credit department or some responsible officer, and the correspondence with the customers examined, so that the reserve for bad and doubtful accounts set up by the company shall be sufficient. If such an account has not been established the auditor should, nevertheless, set up a reserve in the statement so that it will be conservative.

Trade discounts (also so-called "cash discounts," if exceeding 1 per cent) and freight allowances made by the company should be inquired into, and if any of the accounts receivable are subject to such deductions, a reserve for these possible deductions, should be set up on the Statement of Condition, otherwise the actual cash to be realized on the accounts receivable will be overstated. Also, inquiries should be made regarding customers' claims for reductions in prices and for rebates and allowances on account of defective materials, so that the

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....
.....

Dear Sir:

We are engaged upon an audit of the accounts of ..... and it appears that on .....19....there was a balance due from you of $.....

Will you please advise upon the attached blank if the amount is correct and if not, send detailed statement to enable us to rectify the error.

This letter should not be construed as a request for payment, as it is only designed to establish the correctness of the books.

Very truly yours,
JOHN BLANK & COMPANY, INC.
By.....

Please furnish the above information as requested:

.....
.....

.....19....

John Blank & Company, Inc.,
New York.

Dear Sirs:

The correct balance due .....
.....
on .....19.... was $.....
.....
.....

FIG. 8

IMPORTANT

As a necessary part of the periodical examination which we have been requested to make by the Board of Directors of this institution, we ask your kind assistance.

The enclosed statement shows your account as it appears upon the bank's books. Please check it. If we do not hear from you, we will assume the amount shown as a balance to be correct; if, however, a difference exists, please communicate with us so that we may investigate and correct error.

Should it be necessary to correspond, please address:

JOHN BLANK & COMPANY, INC.
New York
Auditors and Public Accountants

IMPORTANT

We are engaged upon an audit of the accounts of the company sending this statement and it appears upon their books that on the date given there was due from you the sum shown.

If we do not hear from you, we will assume the amount to be correct; if, however, a difference exists, please communicate with us so that we may investigate and correct error.

This note should not be construed as a request for payment, as it is only designed to establish the correctness of the books.

Should it be necessary to correspond, please address:

JOHN BLANK & COMPANY, INC.
New York
Auditors and Public Accountants

FIG. 9

auditor may make certain that a sufficient reserve has been established.

Careful inquiry must be made as to whether any of the accounts receivable have been hypothecated or assigned, and, if so, notice thereof should appear on the Statement of Condition either by listing the total of these accounts separately, or by noting the amount of the accounts receivable that are pledged to secure contra-loans.

The auditor should satisfy himself that the writing off of bad debts has been duly authorized by responsible officials, for bookkeepers have been known to write off accounts which have actually been collected in order to cover money diverted into their own pockets.

Accounts due from directors, officers, and employees must appear separately in the Statement of Condition and not be included as trade accounts. This applies also to deposits as security, guarantees, amounts due for freight claims and other extraordinary items not connected with sales.

Accounts due from affiliated concerns must not be included as customers' accounts, even though arising as a result of trading transactions. Affiliated companies' accounts should be shown as a separate item of current assets, if the debtor company has ample margin of quick assets over its liabilities, including such accounts.

Other items of unusual nature, either directly associated with the sales of the client company or having no connection with the sales, should be carefully analyzed. For their verification the auditor must use such means as the nature of the account requires. He must be sure that none of the items are included twice in the assets, as for instance C. O. D. items appearing also in the inventory. Any question of the value of unusual items should be taken up with a responsible officer

of the client, and, when necessary, provision made for possible losses.

Audit examinations, by reason of their variance in character, will bring to the attention of the auditor the necessity for providing for many subdivisions of Accounts Receivable of which the more important items are:

Customers' Accounts—Separate the pledged from the unpledged
Personal Accounts—Officers and Employees
Balances due from affiliated companies
Accounts in attorneys' hands for collection
Accounts in suspense—possibly of no value.

Deposits for water, rent, association dues, etc., but not truly current assets.

C. O. D. items in transit, or unaccounted for
Claims for damages.

Life Insurance, Cash Surrender Value.—The auditor should ascertain whether or not the lives of any officers of the concern are insured in the name of the company. Insurance policies should be examined and should show, if it is a fact that the company is the beneficiary, or that the policy is assigned to the company.

After a certain preliminary period, usually from two to three years, these insurance policies may ordinarily be converted into cash at any time at their cash surrender value, which is a good current asset and should be shown as such on the Statement of Condition. Most policies will be found to contain a schedule showing the cash surrender value at the various premium dates, but a better method of verification is to obtain a certificate from the various insurance companies issuing the policies certifying to the cash surrender value as

on the date of audit. This value should then be set up on the books and the corresponding amount credited to Surplus.

Inventories.—The item of inventory on the usual Statement of Condition commonly represents a large portion of the total of Current Assets. Where a loan is negotiated the bank, or other creditor, wants to know what the inventory consists of, by whom it was taken, and the manner of determining its value at the date of audit. Where there is a close margin of credit the bank, or other creditor, will usually ask for the corresponding figures of the previous year by detailed classification of the various inventory items. Inquiry will be made as to purchase commitments and prices therefor, the method of pricing work in process and finished goods, and the relative value of the inventory compared with current market prices as at the date of the audit.

The majority of audit engagements does not include the physical taking of the inventory, or the actual valuation of it. However, the auditor should not fail to mention by whom the inventory was taken, how valued, and to what extent the inventory figures were verified. On the other hand, if the audit engagement does include the actual inventory count and valuation by the auditor, the auditor should state that fact in the report, with such additional information as will make readily understandable the worth of the inventory, taking into consideration whether it consists of staple merchandise or is subject to constantly changing styles which may make it of little value in a short time.

So varied are the methods of accounting for the inventory, from the time of purchase until sold as a part of a finished product, that instructions for an inventory examination cannot be followed in detail for any investigation. The auditor must use his technical training and skill when making an

inventory count or audit examination, giving due consideration to the methods pursued by the client.

In the inventory account should be included only stocks of goods owned by and under control of the owner. If stocks have been hypothecated that fact should appear in the Statement of Condition.

In presenting the value of an inventory, it is necessary to comment upon the method by which the inventory was verified. If, as often happens, the auditor is not permitted to verify the inventory, he should obtain a certificate from an authorized person (an officer, if a corporation; a firm member, if a partnership) to the effect that the quantities are correct and that the value presented is a live inventory cost valuation.

A form of inventory certificate, which may be modified to meet requirements, is shown as Figure 10, on page 34.

In making a first examination for a new client, the auditor should test the inventories at the beginning and end of the period by percentage of production cost, against sales. Where there is reason to question the value of an inventory this rule should invariably be followed by the auditor.

Material shipped on consignment with no obligation on the part of consignee to pay for it until actual sale is made, should always be included in the inventory at cost of finished product. A record of it should be kept and shown separately from the regular inventory or accounts receivable until the actual sales are made.

Inasmuch as the accuracy of the Statement of Operations is absolutely dependent upon the accuracy of the inventories of merchandise at the beginning and end of the period under review, this part of the verification should receive special attention. When a Statement of Condition audit is being made for the first time, the inventory at the beginning of the period should receive as much attention as that at the end, and the

CERTIFICATE OF INVENTORY

To whom it may concern:

I hereby certify:

That the inventory of merchandise and supplies on hand as at the close of business on .....19.... amounting to $..... was prepared by the Company's employees, according to authorized instructions, and that to the best of my knowledge and belief it is true and complete in every respect.

That the quantities were determined by actual count, weight or measurement, or by conservative estimates where actual count was impracticable.

That the signatures on each inventory sheet are those of the employees of the Company who made the physical count, priced the items and made the calculations.

That ample provision has been made for imperfect goods and for possible depreciation of stock regarded as obsolete or inactive.

That all items included in the inventory have been paid for, or the liability therefor recorded on the books.

That there is not included in the inventory any merchandise charged to customers, or included in cash sales, delivery of which has not been effected as at the date the inventory was taken.

That the pricing of raw material, work in process, and finished goods is—"cost"—or "cost or market" whichever is lower, that the items priced at cost to the company are less trade discounts or allowances.

That all known liabilities have been recorded on the books as at the close of business on .....19...., that there are no pending claims, damages at law, guarantees, agreements, or possible tax deficiency assessments, affecting the financial status of the company, nor are any of the assets hypothecated or assigned.

That all uncompleted contracts, or other commitments, if any, have been noted on the reverse side of this form.

.....
Name of Company

.....
By

.....
Title

Dated .....

FIG. 10

auditor should take every precaution to satisfy himself that both inventories were taken on the same basis.

An acceptable program of audit for inventories follows:

(1) Secure the original stock sheets if they are in existence and carefully test the typewritten copies with them and with tickets, cards, or other memoranda that show the original count.

(2) See that the sheets are certified to or initialed by the persons who took the stock, made the calculations and footings, and fixed the prices, and satisfy yourself that they are dependable and responsible persons. Obtain a clear and detailed statement, preferably in writing, as to the method followed in taking stock and pricing it; also a certificate from a responsible head as to the accuracy of the inventory as a whole.

(3) A thorough test of the accuracy of the footings and extensions should be made, especially of all large items.

(4) The inventories should as far as possible be compared with the stores records, work-in-process records, and finished stock records, as to quantities, prices, and values, and any considerable discrepancy should be thoroughly traced.

(5) Where stock records or perpetual inventory records are kept, and no physical inventory is taken at the time of the audit, ascertain when the last physical inventory was taken and compare it with the book records. If no recent comparison is possible, select a few book items of importance and personally compare with the actual stock on hand.

(6) Where no stock records are kept, a physical inventory should be taken, preferably under the general direction of the auditor. After the inventory is completed, he should apply the same tests to verify its accuracy as if the inventory had been taken before his arrival.

(7) When the cost system of a company does not form a

part of the financial accounting scheme there is always a chance that orders may be completed and billed, but not taken out of the work-in-process records. Especially is this the case when reliance is placed on such records to the extent that a physical inventory is not taken at the end of the period to verify the information shown therein. In these cases the sales for the month preceding the close of the fiscal period should be carefully compared with the orders in progress as shown by the inventory, to see that nothing that has been shipped is wrongly included in the inventory. Cost systems which are not coordinated with the financial accounts are unreliable and frequently misleading. Special attention to the verification of the inventories should be given in every instance where the cost system is not adequately checked by the results of the financial accounting.

(8) Make certain that purchase invoices for all stock included in the inventory have been entered on the books. Look for post-dated invoices and give special attention to goods in transit.

(9) See that nothing is included in the inventory which is not owned but which is on consignment from others. If goods consigned to others are included, see that cost prices are placed thereon, less a proper allowance for loss, damage, or expenses of possible subsequent return. This does not include goods at branches, as the valuing of such stocks will be governed by the same principles as apply at the head office.

(10) Make sure that nothing is included which has been sold and billed, and is simply awaiting shipment.

(11) If duties, freight, insurance, and other direct charges have been added, test them to ascertain that no error has been made. Duties and freight are legitimate additions to the cost price of goods, but no other items should be added except under unusual circumstances. Such items as liquors, piano

wood, and others that improve through seasoning, may rightly have interest and insurance added to their value, if the total value per unit does not exceed the market price for materials of equal quality.

(12) To prevent obsolete or damaged stock being carried in the inventory at an excessive valuation, the detailed records for stores, supplies, work in process, finished products, and purchased stock should be examined and a list prepared of inactive stock accounts. This should be discussed with the company's officials and satisfactory explanations obtained.

(13) The auditor should satisfy himself that inventories are stated at cost or market prices, whichever is the lower on the date of the Statement of Condition. This test applies to each item in the inventory. No inventory should be passed which has been marked up to market prices and a profit assumed that has not and may never be realized. If the market is higher than cost, it is permissible to state that fact in a footnote on the Statement of Condition.

(14) It may be found that inventories are valued at the average prices of raw materials and supplies on hand at the end of the period. If so, the averages should be compared with the latest invoices in order to verify the fact that they are not in excess of the latest prices, and also with the trade papers, when market prices are used, to see that they are not in excess of market values.

(15) Make an independent inspection of the inventory sheets to determine whether or not the quantities are reasonable, and whether they accord in particular instances with the average consumption and average purchases over a fixed period. Abnormally large quantities of stock on hand may be the legitimate result of shrewd foresight in buying in a low market, but may, on the other hand, arise from serious errors in stock taking, or may be an overstock.

(16) Always attempt to check the totals by the "gross profit test" and compare the percentage of gross profit shown with that of previous years. In a business whose average gross profit remains fairly constant this test is a dependable one because, if the rate of gross profit is apparently not maintained and the discrepancy cannot be satisfactorily accounted for by a rise or fall in the cost of production or of the selling price, the difference will usually be due to errors in stock taking.

(17) The best way to verify the prices at which the work-in-process is included in the inventory is to make a general examination and test of the cost system. In a good cost system little difficulty will be found with the distribution of the raw materials, stores, and pay roll, but the distribution of factory overhead is one that should receive careful consideration, the main points to be kept in view being:

(a) That no selling expense or interest charges are included in the factory overhead, and that only that share of administrative expense pertaining to the factory is included.

(b) That the factory overhead is distributed over the various departments, shops, and commodities on a fair and equitable basis.

(18) No profit should be included in the price of finished products or stock in trade. The price list should be examined to see that the cost prices of stock are below the selling prices after allowing for trade discounts. If they are not, a reserve should be set up on the balance sheet for this loss. If the company takes immediate steps to increase the selling price, however, the amount of this reserve may be limited to the loss on goods which may have been sold between the close of the period and the date of the discovery.

(19) Companies manufacturing on large contracts frequently make partial shipments of orders. The question then

arises whether it is permissible to include the profits on these partial shipments in the Statement of Operations. As a matter of fact, it is evident that the actual cost cannot be known until the order is completed. It may be estimated that a profit will ultimately be made, yet unforeseen conditions, such as strikes, delays in receiving material, etc., may arise to increase the estimated cost. It is better not to include the profits on partial shipments, but information of this character which may have its influence in the decision of the banker upon a proposed loan may properly be laid before him, in the comments which accompany the report. Of course, an exception should be made where the profit on the partial shipments largely exceeds the selling price of the balance of the order.

(20) The selling prices for contract work in progress should be ascertained from the contracts, and where it is apparent that there will be a loss on the completed contract a due proportion of the estimated loss should be charged to the period under audit by setting up a reserve for losses on contracts in progress.

(21) If a company has discontinued the manufacture of any of its products the particular items should be carefully scrutinized and, if unsaleable, an amount should be written off to cover all but the scrap value of the articles.

(22) The inventory should be scrutinized to see that no machinery or other material that has been charged to plant or property account is included therein.

(23) Partial deliveries received on account of purchase contracts for material, etc., should be verified by certificate from the contractors, as to both quantities and prices.

(24) Advance payments on account of purchase contracts for future deliveries should never appear in an inventory, but should be shown on the Statement of Condition, under a separate heading.

(25) Trade discounts should be deducted from inventory prices, but it is not customary to deduct cash discounts. However, this may be done when it is the trade practice to do so.

(26) While the inventory is being verified, the auditor should ascertain the aggregate sales for the last year. A slow turnover may have been due to a poor stock of goods. Some business men dislike to sell below cost, and would rather accumulate a big stock of old goods than dispose of the old and unseasonable stock at a sacrifice. The usual outcome is that the stock becomes unwieldly and funds are lacking to purchase new goods. The inventory and the gross sales may have a direct connection.

Since the inventory is one of the important items on the Statement of Condition, the auditor must give careful thought to the means taken to verify quantities and the fairness of prices used in valuation. The detail of the inventory in the work papers should be complete. The comments in the completed report should be informative but concise, giving a general description of the nature of the inventory. That is to say, the marketability of the inventory should be commented on—whether any items are obsolete or apt to become so—what the rate of turnover is, and so forth.

Embodied in the comments should appear a brief statement setting forth by whom the inventory was taken, by whom priced, the completeness of the physical count and reasonableness of valuation and what, if any, provision has been made for declining values of slow moving or obsolete stock, either by reduced value or by a reserve for depreciation of merchandise inventory.

As the inventory is also an important item on the tax return the auditor should have an understanding of the income tax provisions set forth in the current Regulations of the United States Internal Revenue Department.

CHAPTER III

Investments and Sinking Funds

Investments.—Under this caption should be listed the securities owned. Whether they should be classed as Current Assets or shown below the line depends, fundamentally, on the reason for acquiring them, or holding them, with due regard to their marketability, and considering the maturity thereof.

Securities in which surplus funds have been temporarily invested, and which are really quick assets, i.e., readily marketable, and which may be sold without affecting the company's business policy or its operations, may be considered to be Current Assets.

Stocks or bonds which represent control or a material interest in other enterprises, or the ownership of which carries more or less value to the holder aside from the return thereon, or for other reasons must be retained as a part of the capital structure even though readily marketable, should be shown below the line of Current Assets on the Statement of Condition.

Whether the securities are considered to be current assets or otherwise, a list of the investments should be prepared to show:

Dates of purchases
Description of the investments
Par value of the investments
Denomination of the shares
Number of shares or bonds owned
Total capital stock of the various companies

Amounts paid for the investments
Interest and dividends received
Market values of the investments
The surplus or deficit shown by the statement of condition of the companies, where no market quotations are available
If hypothecated, with whom and for what purpose.

This list must be compared with the ledger accounts and the total of amounts paid according to the list must agree with the balance of the investment accounts.

The securities must be examined by the auditor in person or he must secure confirmation of their existence from those who hold them as collateral. Those in the company's possession must be counted and examined as soon after the audit starts as possible, and all of them must be submitted at one time. It is much more satisfactory to see the actual securities than to verify cash receipts and other evidence after the audit has progressed.

Certificates out for transfer must be verified by correspondence.

Where the market values of securities are less than the values at which they are carried on the books, save where the variation is so small as to be trifling, consideration should be given to setting up a reserve for loss in value on the date of the Statement of Condition.

The auditor should determine and comment upon the value at which the securities owned are carried: whether it is cost or par, and whether the returns from the investment warrant the value at which they are carried on the books.

Care must be taken to see that the certificates are made out in favor of the company, or that they are endorsed or accompanied by powers of attorney when they are in the names of individuals.

Coupons on bonds must be examined to see that they are intact subsequent to the latest interest payment date.

The investment schedule must show that the interest and dividends receivable by the company have been duly accounted for. The income from the investments shown in the Statement of Operations must be in accord with this schedule.

When market quotations for investments cannot be obtained, the Statements of Condition of the companies in which investments are held must be examined so that the auditor may form an idea of their value.

In verifying purchases of stock exchange securities the brokers' statements must always be examined in connection with the verification of the purchase price.

Investments and mortgages must be supported by an examination of both the mortgages and insurance policies, and furthermore it must be shown that all assessed taxes on the property have been duly paid, that the mortgages have been properly recorded, and that the insurance policies are correctly made out to the company.

If any of the securities have been hypothecated, the fact and amount (book value) must be stated, either under the liability for which the securities have been pledged or on the asset side of the Statement of Condition by listing the amount separately.

The individual investment items, unless there are too many, should, as a rule, be shown separately on the Statement of Condition. Where the number of items is so large as to make listing inadvisable, they should be listed in the comments of the finished report, or shown on a separate accompanying schedule.

Stocks and bonds of a corporation should never be shown as an Investment on its own Statement of Condition. They

should appear as Treasury Securities or be deducted from the proper item on the liability side of the Statement of Operations.

Sinking Funds.—Sinking funds should not be included with the current assets. Such a fund may consist of cash or securities, or both. The indenture providing for the fund should specify whether interest accruing on the fund is to remain a part of the fund. If so it should be accrued at the time of the audit and added to the amount of the Sinking Fund. The auditor should assure himself that the Sinking Fund requirements are being complied with, and the trustee should be asked for a certificate showing the composition of the funds on hand. The Sinking Fund should be shown on the Statement of Condition in detail, i.e.:

Cash
Securities
Accrued Interest.

Further reference to this account is made under the heading of Bond and Mortgage Debt.

CHAPTER IV

Fixed and Other Assets

Plant and Equipment.—The items comprising Plant and Equipment should be grouped on the Statement of Condition to show clearly the nature of the items. The accounts should present the value of the permanent investment in real estate, property rights, buildings, machinery, furniture and fixtures, tools, etc. The value shown should be either actual cost or a properly appraised value and the basis of such valuation should be made clear either on the statement or in the comments. The auditor should know beyond doubt that the items included in the plant inventory are the property of the client. If there is any doubt of this fact a certificate of the ownership of the plant property should be obtained from a responsible officer of the client.

Where capital stock is issued for what is commonly called "water," be sure to comment upon it when found in any of the accounts under this caption.

Where credits have been applied to ledger values for any property sold, see that such credits agree with the original charges or their proper proportions. Where reserves for depreciation are carried, the loss on the sale of a Plant and Equipment items should be determined as follows: First, the original cost of the item must be credited to the asset account, while the amount of depreciation charged on the item under consideration should be debited to the Depreciation Reserve. The difference between the cost of the item, less depreciation, and the selling price is an amount chargeable to the Profit

and Loss account. Of course, if the item is sold at a profit, the profit is a credit to Profit and Loss account.

The auditor must guard against sales of plant equipment being credited to the sales account, thereby overstating that account and leaving in the plant equipment an asset item no longer in existence.

The book value of property rights, such as coal veins, where only the coal to be mined is owned, and timber tracts, where the ownership is in standing timber only, should be reduced in proportion to the output from the property. This should be based on an engineering appraisal.

In preparing the leading schedules for the accounts grouped under this heading, such as real estate, buildings, plant, machinery, etc., the balances at the beginning of the period, the additions to or deductions from the accounts during the year, and the balances at the end of the period must be shown.

The total of the balances of the period must agree with the cost of property figures given in the Statement of Condition at that date, and the balances at the end of the period with the amount shown in the Statement of Condition that is being audited. The charges entering into the additions must be verified in detail, and in this connection the following notes are of value:

(1) Authorizations for the expenditures made during the year should be examined, and where the cost of the additions have overrun the sums authorized, inquiries should be made about them. The authorizations should show the accounts to which the expenditures are chargeable, the amounts thereof, the approvals of the comptroller and manager, and descriptions of the jobs. When the authorizations are not specific as to the work done, the actual additions should, if possible, be inspected.

(2) The auditor should satisfy himself, before approving

additions, that they were made with the object of increasing the earning capacity of the plant, and that they are not of the nature of either renewals or improvements, and in this connection changes in the production and capacity of the plant should receive consideration.

(3) To verify the pay roll and store and supply charges to jobs, one or two pay roll distribution reports should be examined in detail, and also one or two storehouse reports. If large purchases have been made from outside parties for capital construction work, the vouchers therefor should be examined and the usual precautions taken to see that they are properly approved for the receipt of materials, prices, etc.

(4) For purchases of real estate the title deeds should be examined, together with the vouchers, and it should be seen that the deeds have been properly recorded. Where title deeds are not available, or where there appears a probability of a later transfer of property, an examination should be made of the official county records.

(5) While it may be considered permissible to make a charge for factory overhead to additions to property, such as time of superintendent and his clerical force employed on construction work, etc., it cannot be deemed conservative business practice, inasmuch as the probabilities are that the overhead charges of a plant will not be decreased to any extent even though additions are not under way, and, therefore, the absorption of part of these charges when additions are in progress has the effect of reducing the operating costs, as compared with months in which no construction work is under way.

(6) Construction work in progress at the end of the fiscal period should be shown in the Statement of Condition under the heading of Fixed Assets and not as part of Inventories. This is important to bear in mind because construction work

is not an asset that can be quickly turned into money, while everything in the inventory is supposed to be capable of ready conversion into cash.

(7) The auditor should determine whether any installments are due on account of construction work in progress which is being carried on by outsiders. If so, the amount of such installments should be added to the assets, and the liabilities for such installments included as a liability in the Statement of Condition, as they may have a direct bearing on the amount of available cash on hand. The auditor should be careful to ascertain that no profit has been taken on the cost of improvements where the total cost is less than estimates received for such work, or where the cost is less than the cost for similar construction or improvement work.

(8) When a company uses leasehold properties, the leases should be examined and notes made of the periods covered, so that it may be seen that improvements, etc., on such properties, including a proportionate value of the purchase price, are written off over the periods covered by the leases. The yearly write-off should be so prorated that the purchase price, and subsequent improvements over the remaining years of use, will be expunged at the expiration of the leases. On the Statement of Condition should appear the leasehold value, amortization, and unamortized value.

(9) The auditor should satisfy himself that the reserves for depreciation of buildings, machinery, equipment, etc., are adequate to reflect the deterioration in the value of the fixed properties.

In the determination of the adequacy of the reserves for depreciation the auditor should give careful attention to the unit of value on which depreciation is taken. Land, as a rule, is not subject to depreciation. Building depreciation will vary according to methods of, and materials used in, construction,

and the use to which it is put. Buildings erected on leased land should as a rule be depreciated over the term of the lease, depending, of course, upon the provisions of the lease itself. Usually at the expiration of the lease the buildings thereon revert to the owner of the land, and hence are of no further value to the lessee. Machinery, equipment, etc., which in addition to depreciation is subject to obsolescence requires a higher basic rate for depreciation. Coal mines, ore mines, etc., are usually depleted in the ratio that the output for the year bears to the total estimated output of the mine.

The rate of depreciation for any item may not be the same in any two concerns. Each concern may have a basis of computation peculiar to itself, both of which, theoretically, may be correct. The auditor, in addition to his technical knowledge of depreciation methods, should be thoroughly conversant with the basis for depreciation as outlined in the Income Tax Regulations of the United States Internal Revenue Department.

If in his opinion the reserves shown on the balance sheet are insufficient, he should call attention to the matter in the comments that are a part of the report.

(10) Make sure that property destroyed by fire or otherwise prematurely put out of service is correctly treated in the books. Any portion of the original charge for such property which is not recoverable through insurance, salvage, or otherwise, and has not been provided for by the depreciation scheme, should be written off.

It is to be observed that the foregoing notes are to be applied only to cost of properties incurred during the period under audit. In addition, information may well be obtained on broader lines in regard to the composition of the real estate, building, and machinery accounts; to show what principal property is represented thereby; and how the accounts

have been built up from year to year for a reasonable time past if not from the inception of the business. The information thus derived is valuable only in indicating the progressive policy of the concern, the extent to which it reinvests undivided surplus in its plant, etc. Beyond these facts the banker who is asked for ordinary discounts or short-term loans is not interested; he looks more to the quick assets for his security.

When a loan is asked which is greater than the quick assets seem to justify, the auditor should suggest that a reliable verification be made as to the cost of the property prior to the period under audit. Such action may become necessary even to the extent of calling for an appraisal by disinterested outside experts.

Reserve for Depreciation.—Reserve for Depreciation is a division of surplus set aside to provide for the impairment in the value of an asset due to physical wear and tear, and obsolescene. Where it can be avoided, reserves should never be credited direct to the capital accounts, for the reason that in doing this an estimated amount is credited to an account which should reflect nothing but known values.

Where conditions warrant reserves for depreciation which have not been provided, reasons should be given and the examiner's judgment should be stated. It should be borne in mind, however, that the rates of depreciation are really more of an engineering question than an accounting one.

A desirable method for showing the Reserve for Depreciation is shown in Figure 13 on page 78. This form provides for the Depreciation Reserve to be deducted from the value of the fixed asset. If there are not too many such accounts, the depreciation may be shown for each item separately, reflecting the net value of each account. Occasionally, a client will insist on Depreciation Reserves appearing on the liability side of the Statement of Condition. There

is no objection to such procedure provided the liability is given a proper terminology and is not grouped with the Surplus account.

Goodwill.—Where the item of goodwill is encountered in an examination, show the amount on the Statement of Condition under a separate caption directly below plant and property, and comment as to how it was created.

The auditor's duty in connection with this account is to verify its purchase price. Recognized accounting practice does not condone arbitrarily increasing its cost value. As banks, or other creditors, give little or no value to this item, there is no real reason for writing it off, although it is frequently done. If the item is separately stated, and shown at cost, the auditor is not required to express his views of the account as shown, unless asked to do so by the management.

In the purchase or sale of a business it is a recognized fact that Goodwill does have a value, and when a request is made to determine that value the accepted methods for calculating it should be followed.

Patents.—This account should include purchased patents at purchase price. This amount should be written off, at least, within the legal life of the patent; sooner, if the patented article becomes antiquated or is made obsolete by a more modern invention.

If the article is patented and brought to perfection by the inventor and manufacturer, its asset value is questionable. The actual cost of planning, making patterns, patent fees, etc., is rightfully a part of the cost of the patent.

Organization or Development.—The extraordinary costs of starting a new business or developing an old one may reasonably be distributed over a period of years, determined by the condition of the business, or a pro rata amount of such expenses charged annually to operations. In the meantime, the

undistributed portion should be shown on the balance sheet as a deferred charge to operation.

Expenses included in this account will be found to be for attorneys' fees, incorporation fees, cost of printing and issuing stock certificates, experimentation or development expenses, and items of a similar nature, necessarily incurred to establish a concern as a going business. Expenses for experimentation or development, especially if patents and processes are involved, are likely to be continued over a period of time. Particularly is this true of articles which must conform to designated standards or formulas before being marketable. Such expenses need to be carefully analyzed by the auditor.

The Internal Revenue Department has arbitrarily ruled that the extraordinary cost of starting a new business or developing an old one cannot be charged off either at one time or over a period of years as a deduction from income. As a result thereof, such cost should be segregated into an account classified as "organization expense." Its place on the Statement of Condition should be immediately after the setting up of the so-called Fixed Capital section. For the company's own convenience, from the point of conservatism, this account can be written off, as there is nothing to prevent such an operation, but it must be borne in mind that whatever is written off is not an allowable deduction in computing net income subject to the federal income tax.

Good accounting practice, if revenue permits, would require that such expenses be written off in from 3 to 5 years, although financial conditions may require a much longer period. In any event, where patents are involved, the write-off period should not exceed the legal life of the patent itself.

Deferred Charges to Operations.—Under this heading in the Statement of Condition are grouped such items as unexpired insurance, discounts applicable to a future period,

prepaid royalties, experimental charges, etc. As a matter of clarity the items composing this account, on the Statement of Condition, should be shown separately. They should be grouped as easily to distinguish those items having no value in the event of liquidation, such as bond discount, selling expenses, etc., and those items which do have such value, i.e., prepaid insurance, prepaid rent if recoverable, prepaid interest, salaries, wages, etc.

Prepaid expenses as a general rule are determined by the client's employees, the auditor simply assuring himself that all the items are, and have been, properly included, and that the prepaid calculations are correct. After the clerical accuracy of the deferred charges has been verified, the auditor should satisfy himself that they are properly carried forward to future operations.

Deferred charges should be scrutinized for actual remaining value. Such a charge set up to be written off over a period of, say, five years may, due to change of policy of the management or unforeseen circumstances, have no value after the first year. Whatever the remaining balance, it should be written off.

Whenever possible, documentary proof must be produced in support of the items carried forward. For example, with unexpired insurance the policies must be examined to verify the dates of expiration, the amounts covered, and the proportion of the premiums carried forward; with royalties, the agreements must be examined; with experimental charges, the vouchers and particulars of the work done must be looked into.

Many concerns inventory stationery, advertising matter, and other items of a miscellaneous nature at the end of the fiscal periods. Do not treat such items under the general head

of Inventory, but present them under Prepaid Operating Expenses.

Postage of a current nature, and items such as advances to salesmen for salaries or expenses, which will eventually be taken up in the operation, should be shown on the Statement of Condition as prepaid operating expenses.

Bills for merchandise paid in advance of receipt of goods should be presented under Current Assets.

Large advances to subsidiary concerns or to individuals in anticipation of the division of profits or dividends, should be carefully investigated to ascertain their exact nature. It is often well to present advances of this sort under a separate caption of Advances, which should follow Inventory and Current Assets.

The examination of deferred charges will usually furnish the auditor with valuable information in regard to the accounts of the company. For example:

(1) The verification of experimental charges carried forward may give information as to the production and future policy of the company.

(2) Royalty vouchers will sometimes give a check on the production of mines.

(3) An examination of the insurance policies will show if the properties are mortgaged or covered by lien, and will thus be an additional verification of the liability for mortgages on real estates, buildings, etc., shown in the Statement of Condition.

(4) The insurance should be checked against the assets and, if any of the latter are not covered, the omission should be mentioned.

The auditor will often find included in Deferred Charges to Operations the item of Coal Inventory. This is not a prepaid expense nor is it a deferred charge to operations. Any

inventory such as this should be classified as such, for coal when used in manufacturing is just as important an element of operation as the raw material which is being fabricated.

Expenses for experimentation, organization, and development are frequently set up as Deferred Charges to Operations. It makes little difference whether these items appear on the Statement of Condition under the caption of Deferred Charges to Operations, or grouped alone, so long as each item is properly designated. As a matter of preference, it is better to group the accounts under separate captions.

Unamortized Discount and Expense is an item frequently found under the heading of Deferred Charges. The commonly accepted method for amortization is equal annual installments over the life of the bonds. The amount of unamortized discount should represent that proportion of discount applicable to the principal of the bonds or notes outstanding at any particular date. In other words, if bonds are retired in advance of the maturity date the proportion of discount and expense applicable to the retired bonds should be written off.

CHAPTER V

Liabilities and Capital

Notes and Bills Payable.—Under this caption also appear Loans and Drafts Accepted. Since banks or others from whom a concern may wish a loan will desire to know the extent of this liability, if any, to banks, trade creditors, associated companies, and to officers, employees and others, the account on the Statement of Condition should be set up with the sub-captions necessary clearly to classify the indebtedness.

It is desirable, as an arbitrary division of current and deferred liabilities, that notes and bills payable due within one year from the date of the Statement of Condition be considered a current liability, and those due over one year from such date be shown below the line of Current Liabilities.

Whether the liability is current or deferred, the auditor should prepare a schedule classifying the indebtedness under its proper sub-captions, and for each a record of:

Date of making the notes or drafts
Due dates
Names of creditors
Collateral hypothecated
Additional indorsers
Interest accrued to date of audit
Notations of renewals (as information of this nature furnishes a guide to the state of the concern's credit).

The schedule must be compared with the notes payable records and the total of the aggregate must agree with the balance of the ledger account of Notes Payable.

Notes Payable should be verified by correspondence with the holders. If for any reason they are not so verified, the auditor should state that fact in his report. Verification by correspondence is only conclusive insofar as the liability is recorded. Statements should also be secured from each of the company's depositaries as to the liability for notes and loans. This information may be requested when asking for verification of bank balances by use of form shown as Fig. 6—7 on pages 19 to 21.

Statement must be obtained from all banks of notes sold by them for the benefit of the concern. These statements, when received, must be checked against the loan shown on the concern's books.

Examination of cash book entries, and the interest account, may disclose payments made on account of notes not recorded.

Inasmuch as a note is a negotiable instrument, care must be taken to see that all of those recorded as paid during the year under audit have been properly discharged, and the canceled notes are the best evidence of this fact.

Careful attention must be given to the collateral deposited for loans, and statements as to the existence of such collateral should be obtained from the holders thereof. Such hypothecations of any of the concern's assets should be accounted for on the Statement of Condition.

Money borrowed from banks or individuals should be listed as Loans Payable, and distinct from Notes Payable, which should include such obligations as are given in settlement of creditors' accounts for merchandise, etc.

The auditor should verify the interest accrued on notes payable as calculated by the client's employees. If such a record is not available, the auditor should make his own calculations to determine the accrued interest liability at the date of audit.

When practicable the auditor might suggest to the client the advisability of drawing notes on blanks bound in a book, like a check book, with a stub or carbon copy record of each blank, the blank and the stub or copy to bear identical numbers. The officer, or officers, signing the notes could, in such case, initial the stub to certify the correctness of the amounts, payees, and terms of the notes issued. If this were done, the auditing of bills payable would be greatly facilitated.

Accounts Payable.—The average audit engagement does not presume the verification of Accounts Payable through the medium of correspondence with the creditors. If so verified there always remains the possibility of unrecorded items. Whether the accounts are to be verified by correspondence, or only an analysis made of the open account balances, the auditor must use that precaution suggested to be necessary by the company's own method of handling and maintaining the record of its liabilities to creditors to assure himself that all liabilities are recorded.

Comparison of the balance appearing on a creditor's monthly statement with the amount shown to be owing will afford a means of proving the correctness of the account or exposing differences. Where a satisfactory explanation of differences is not obtainable, verify the item by correspondence with the creditor. The auditor should assume that every creditor renders a periodical statement and failure to produce one requires the verification of the account by correspondence. A form for this purpose is shown as Fig. 11 on page 59.

A list of balances due on open accounts must be prepared and carefully checked with the ledger accounts, care being taken to see that no open account on the ledger has been omitted from the list. It should be ascertained that the balances represent specific and recent items only. When any account does not appear regular, a statement from the creditor

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....19....

.....

.....

Dear Sir:

We are engaged upon an audit of the books and accounts of ..... and it appears that on .....19.... there was due to you a balance of $.....

Will you please advise upon the attached blank if the amount is correct, as of the date shown, irrespective of subsequent payments or increases of indebtedness? If it is not please send a detailed statement to enable us to rectify the error.

The work we are engaged upon is in behalf of the company being audited and is designed for the verification of the condition of the books only.

Your compliance with our request will be appreciated.

Very truly yours,
JOHN BLANK & COMPANY, INC.
By.....

.....19....

John Blank & Company, Inc.,
New York.

Dear Sirs:

The correct balance due us by the .....
.....
on .....19.... was $.....
.....

FIG. 11

should be obtained. If there are many such accounts in dispute, and they amount to so large a sum as to affect appreciably the total of current liabilities, the general causes for the disputes should be inquired into and note made of the matter.

In concerns with a modern charge register system, Accounts Payable are easily verified, as all liabilities are then included in the books when incurred. Care should be taken, however, to see that all goods received on the last day of the fiscal period, as shown by the receiving records, and also all goods that were in transit and belonged to the concern on that date, are included as liabilities, and the corresponding assets included in the inventories. This test is necessary as an increase in the Accounts Payable may have an important bearing on the financial position of the concern if the cash on hand is small.

Monthly expenses outstanding can usually be ascertained by a comparison of the expenses of the last month of the fiscal period with previous months, and those of the year with the previous year. The charge register should, however, be examined for the months subsequent to the close of the fiscal year, to find out if any expenses included therein are applicable to the fiscal period under audit.

When a first-class system is not in operation, the auditor must take additional precautions to satisfy himself that all liabilities are included in the accounts, among which may be mentioned:

(1) Payments made in the months subsequent to the date of the fiscal period as shown by the cash book, which should be carefully scrutinized to see that none of them are applicable to the period under review.

(2) The file of bills not vouchered or entered on the books should be examined to see that none of them belong to the period under audit.

(3) There is a little likelihood of liabilities being overstated. However, the auditor should view with suspicion duplicate invoices. They present (a) possibility of duplicate payment; (b) an opportunity for the client's employees to defraud the company; and (c) a means for a concern intentionally to hide profits.

(4) A careful perusal of the minutes of a company may further assist the auditor in determining liabilities.

When a company has large purchase contracts in force for future delivery they should be examined, for, if the contract prices are greater than market prices, it might be necessary to set up a reserve for this loss. Any debit balance, due to advance payments or any other cause, should be down on the Statement of Condition, under separate heading.

If the business under audit is one in which there is any possibility of goods having been received on consignment, and part or all of such goods having been sold without a liability therefor having been shown in the books, the auditor must be sure to cover the point fully. This may readily happen, as consignment accounts are usually treated as memoranda only.

If inquiry shows that goods have been received on consignment, all pertinent records should be called for. If the goods have all been sold, the consignors' account should show the full amount due, and, if the debt is a current one, the amount will appear among Accounts Payable Due to Trade Creditors. Where only part of the goods have been sold, the net proceeds due to the consignors should be shown on the Statement of Condition under the caption of Accounts Payable to Consignors.

As an additional precaution against the omission of liabilities, a statement should be obtained from the proper officer or member of the concern stating that all outstanding liabilities for purchases and expenses have been included in the accounts

of the period under review, or of former periods. In many cases it is also advisable to obtain a certificate from the president stating that all liabilities for legal claims, infringements of patents, claims for damages, bank loans, etc., have been included, as he may be the only executive officer of the company to know the extent of such obligations.

Every effort should be made to see that all liabilities are entered on the books, during the month that such liability is incurred, and that all liabilities are reflected upon the records as of the date of closing of the period under review. Especially is this necessary where an auditor is called upon to make monthly audits and present monthly Statements of Condition and Operating Statements.

All debit balances of the Accounts Payable account should be carefully investigated. If proper they should be included on the Statement of Condition with the Accounts Receivable, or shown as a separate item immediately thereunder.

Banks, or other creditors, will almost invariably want to know the nature of the Accounts Payable, whether they are past due, whether discounts are taken, and the amount of personal accounts of stockholders, officers, or employees. If there are such personal accounts, the creditor would probably want to know whether the claims of general creditors would be given preference. The auditor may not be called upon to comment on all of these features in the comments on the audit, it more properly being left to the bank or other creditor to make such inquiry direct. However, on the Statement of Condition the sub-captions of the Accounts Payable should show in detail the composition of the account—as:

Trade creditors
Stockholders, officers, and employees
Associated companies

Credit balances of accounts receivable
Miscellaneous (given proper terminology).

Accrued Liabilities.—Under this caption are grouped such items as interest, taxes, wages, etc., which have accrued to the end of the period under audit, but are not due and payable until a later date. The verification of such items can be accurately made from the books and records. Special attention should be given the following points:

Many of the liabilities which appear on a Statement of Condition carry interest. Such items as bonds and notes payable obviously do, but the auditor should also consider the possibility of accounts bearing interest, as enough book accounts, when past due, may bear interest to warrant inquiry being made. Loan accounts of partners and officers of corporations almost invariably bear interest; also judgments, overdue taxes, and other liens.

The amount of accrued state and local taxes can be ascertained from an examination of the latest tax receipts; although sometimes, as the period for which the taxes are paid is not shown on the receipt, it may be necessary to inquire of the proper taxing authorities as to the period covered.

Under the Federal Income Tax Law, a tax is imposed upon the net profits of a corporation, which must be paid even if the corporation is dissolved before the end of the year during which the tax is imposed. As the tax is specifically based upon the net profits of a particular period, although payable some months thereafter, the tax accrues throughout the specified period, and if a net profit is disclosed upon the closing of the books, no Statement of Condition should be issued without a reserve for federal and state taxes being established, for the sum involved is seldom inconsequential.

At the end of a fiscal year, the federal taxes based on the

income for that year become a current liability, for, even though the taxes are paid in installments, they must be fully paid within one year. Prior to the close of the fiscal period, provision for federal taxes may appear as a Reserve for Taxes or under Accrued Liabilities. The same situation is true with respect to dividends; once formally declared by a board of directors they become a current Liability and should be shown as such on a Statement of Condition. On the other hand, many corporations consider preferred stock dividends as fixed charges and accrue them on the books. Such accruals up to the date of declaration should be shown as a Reserve or under Accrued Liabilities.

When the date of the Statement of Condition does not coincide with the date to which the last pay roll of the period under audit has been calculated, the amount accrued to the date of the Statement of Condition must be ascertained and entered as a liability, unless such amount is trifling. It will suffice to take the proper number of sixths of a full week's pay roll (six days) without reference to possible daily variations.

In a large business, where an accumulation of unclaimed wages is in the custody of the cashier, the amount stated to be on hand should be examined to prevent its being diverted temporarily to cover shortage in the petty cash fund. Where unclaimed wages reach a considerable amount, they should be redeposited and credited periodically to a ledger account entitled Unclaimed Wages.

Where bills for such expenses as water, gas, etc., are not rendered monthly, the auditor must enter as a liability the accrual of the proper proportion since the last bill.

It is important to note whether the accounts of all traveling salesmen have been received and entered before the books are closed. The auditor should secure a list, and if any report

was not so entered, provision should be made for it unless the amount is likely to be trifling.

Ample provision should be made for all commissions eventually payable on sales which have been billed to customers. As commissions are frequently not payable to salesmen until the accounts have been collected from the customers, accrued commissions are often omitted from the books. As they must, however, be paid out of the proceeds of the sales of which the full profit has already been taken into the accounts, they should be set up on the Statement of Condition as an accrued liability.

All concerns have more or less litigation. Before the books are closed the lawyers should be requested to send in a bill to date. If one is not found, the auditor should ascertain the amount probably due and set it up as an accrued liability.

If the concern is insured against liability for damages to employees or the public, a proportion of the premiums paid in advance for the unexpired time covered by the insurance will appear in Deferred Charges. But there may be claims or suits for other damages not covered by insurance, and where the auditor finds any evidence which leads him to suspect that there may be liability of this nature, he should insist upon being informed of all the facts. He can then form an accurate opinion as to the amount that should be set up as an accrued liability or, if the outcome is uncertain, as a reserve against possible loss.

Bonded and Mortgage Debt.—The amount of bonds authorized, issued, and in treasury, rate of interest, and duration of the bonds, should be shown on the Statement of Condition. A certificate should be obtained from the trust company, certifying the amount of bonds authorized, outstanding, unissued, and retired, as verification of the liability

shown in the Statement of Condition. The interest on the bonds, as shown in the Statement of Condition should be calculated and reconciled with the interest on bonds, as shown in the Statement of Operations. Bonds unissued are in no sense treasury holdings. To be such, they must have been certified and delivered by the trustee.

Bonds redeemed during the period or previously, should be examined to see that they have been properly canceled, or, if they have been destroyed, a cremation certificate should be obtained from the trustees.

Funds or securities on deposit with a trustee or agent for this purpose should be verified by a certificate received direct from the depositary.

Where this fund is applied periodically to the cancellation of bonds thereby actually reducing the bonded debt, instead of cash or bonds being carried in the sinking fund, show the amount of bonds so retired as a reduction from the bonds issued on the liability side of the Statement of Condition and verify the retirement of such bonds by a certificate from the trustee.

A copy of the mortgages must be examined and the terms thereof noted.

Sinking fund provisions in mortgages should be carefully noted and care should be taken to see that they are provided for in the accounts of the company, and any default noted in the Statement of Condition.

Mortgages sometimes stipulate that the current assets must be maintained at a certain amount in excess of the current liabilities, and the auditor must give due consideration to such matters and any other stipulation in regard to the accounts, or any audit thereof, that may be referred to in the trust deed, and see that they have been complied with.

As a mortgage derives its chief value from the fact that

upon registry it becomes a lien, the auditor should verify the existence of such an obligation by inspecting the public records, not only with reference to such as may be found on the company's books, but also any that may still appear on the public records as unsatisfied. If the auditor lacks the necessary facilitities for making a search, it will be worth his while to arrange with a local lawyer or title company to report to him any mortgages or judgments entered against the concern.

In any event, the auditor must verify the amount as recorded in the account, the rate, the due date, and the property covered thereby.

It should be borne in mind that a payment on account of a mortgage must be recorded or the entire amount will remain as an encumbrance on the property. Therefore, if payments on account appear, the auditor should ascertain if they have been so recorded; if not, the fact should be noted on the Statement of Condition.

The same procedure should be followed in verifying judgments as in verifying mortgages. As many business men consider that the entry of an invoice is an admission of liability, and will not permit the entry of a claim which they propose to fight, it is sometimes difficult for an auditor to find any evidence of such liens. Even admitting the fact, they may still refuse to allow the judgment to be entered on the books as a liability. In this event it is proper for the auditor to include it as a footnote to the Statement of Condition as a contingent liability.

When considering liens it should be noted that interest unpaid is a lien as well as unpaid principal, so where the auditor finds evidence of interest on liens being in default, he should add it to the principal in each case.

Sinking funds, properly treated as an asset on the State-

ment of Condition, owe their origination to the provisions made for bond redemption, payment of mortgages, and occasionally the retirement of certain stock issues; hence reference to such funds is made in connection with the Bond and Mortgage Liabilities. Whenever a Sinking Fund account appears, or when it is determined from an examination of the various forms of indebtedness that such a fund should be created, the auditor should obtain all of the facts in connection therewith. A copy of the bond indenture, mortgage, or of the certificate of incorporation, if stock is involved, should be secured and filed with the permanent work papers. If it is not possible to obtain a copy of such indentures, a transcript of the sinking fund provision should be made a part of the permanent work papers.

While it is customary for sinking funds to be placed in the hands of a designated trustee, some concerns elect to provide their own Sinking Fund account. Whatever procedure may be followed by the client, the account should be carefully checked for accruments, including interest or other income. The disbursements for securities purchased, and expenses directly and legitimately attributable to the fund, should be analyzed. As a true sinking fund is in reality an impoundment of cash or marketable securities, it must accumulate interest. Both the principal and interest, or only the principal, may be used to expunge the liability for which the fund was created. The indenture itself ought to be clear on this point. If interest is to remain in the fund it should be accrued at the time of the audit, and added to the amount of the sinking fund. The trustee of the sinking fund should be requested to submit a certificate of the balance of the fund. The composition of the fund should be shown on the Statement of Condition, as for instance:

Sinking Fund:
  Cash
  Securities
  Accrued interest.

Where the provisions of an indenture creating such a fund have not been complied with, or the provisions are inadequate, all of the relevant facts should be ascertained and made a part of the auditor's comments. The comments should state clearly what the provisions are, what has been done, and what remains to be done. On page 124 will be found a few brief suggestions which the auditor may condense or enlarge, as the facts warrant.

The auditor should not be content to accept the general practice of showing the amount of bonds and mortgages immediately under Current Liabilities on the Statement of Condition. Any part of the indebtedness becoming due within one year from the date shown on the Statement of Condition should be treated as a current liability. Even though it is ascertained that the liability due within one year may possibly be renewed as a fixed liability, the existent current liability remains a fact until a definite fixed liability is substituted. The auditor's comments on the audit should relate the facts.

Reserves.—The ordinary meaning of a reserve is that it is a part of the surplus set aside for a specific reason, the intent of which is to prevent dividends from being declared from that portion of the surplus so set aside. Theoretically, it is a misnomer to show a reserve on a Statement of Condition reflecting a deficit, as there is nothing to reserve.

A so-called depreciation reserve in reality is not a reserve at all, but simply the adjustment in the value of an asset account, the proof of which may be found in its deduction from the asset account on the Statement of Condition. In the same manner the ordinary reserve for taxes is nothing more than

an accrued liability. The corresponding debits for both of these items are chargeable against operations and represent an actual expense charge, even though the exact amount may be unknown at the time.

The auditor should make certain that a reserve is set up against every possible loss. A figure labeled Surplus on a Statement of Condition is reasonably indicative that the whole amount is available for dividends. If there is a known likelihood of the impairment of that surplus, a reserve should be established for the contingency, which may be designated Reserve for Contingencies.

Capital Stock.—The amount of authorized issue should be verified by an inspection of the certificate of incorporation, and if additions to the original amount have been made, by an inspection of the authority from the stockholders and directors, as reflected in the minute book, as well as authority from the state for the increase. Stock authorized and unissued should be shown as "unissued," and not as "treasury holdings." If canceled certificates are not properly recorded, list exceptions.

As a rule, trust companies are the transfer agents for the capital stock of large corporations, and for verification purposes it is sufficient to obtain letters from them certifying to the capital stock outstanding.

With companies which issue their own stock, the stock registers and stock certificate books should be examined and compared with the lists of outstanding stockholders.

In the Statement of Condition each class of stock must be stated, giving amount authorized, issued, and in treasury.

If stock has been sold on the installment plan, the auditor should ascertain that the calls have been properly extended to the stockholders. Approval of the board of directors is necessary and the minutes should be examined accordingly.

If any stock has been sold during the period under audit, the auditor should verify the proceeds of the sales.

Proper authority should be found in the minutes book for all dividends declared. A record should be made of dividends paid, showing for each class of stock the date declared, rate, amount, and date paid. Dividends declared but unpaid should appear on the Statement of Condition as a current liability. If a concern has cumulative stock outstanding on which dividends have accrued, but not declared, a note must be made on the Statement of Condition to show the existent liability. The auditor should note the manner of dividend distribution and ultimate payment thereof. Dividends on treasury stock may, at first thought, appear unusual; on the other hand, concerns have been known to purchase their own stock as an investment, declare dividends thereon, and show the earnings as Other Income. Note carefully how such dividends are accounted for.

No par stock should ordinarily be valued at the amount received for it. In some states, however, legal sanction has been given to the practice of placing a value on the stock and crediting the balance of the amount received to Surplus. If this is done, the excess over and above the arbitrary value put on the stock should go to Capital Surplus.

The minutes and any other records relating to the issuance of no par value stock should be scrutinized to ascertain that the value ascribed, as appears on the Statement of Condition, has been duly authorized by the directors and does not conflict with the statutory laws of the state of incorporation. Ascertain whether cash has been received for such stock or if it was issued for some consideration. If the latter, note the method of accounting. On the assumption that no par value stock is entitled to the surplus, that item is often omitted from a Statement of Condition, the value of the no par stock increas-

ing or decreasing with the profits or losses of the concern. The better method is to carry the no par value stock at the value issued and establish a Surplus account to reflect the gains or losses.

Ascertain whether any of the stock issues contain restricting provisions, i.e., that the ratio of current assets to current liabilities shall not be less than a fixed minimum; that dividends may be declared only under certain conditions; that additional stock issuance is contingent upon the achieving of a specified result, etc. Whatever the nature of the restrictions, the auditor must determine that they are, or are not, complied with. A concise statement of the facts should be made in the report.

Treasury Stock and Bonds.—Capital stock becomes treasury holdings, after it has been issued for value received and has been returned to the company, as when capital stock is donated for working capital or purchased by the company.

Bonds become treasury holdings after they have been certified by the trustees and delivered.

When treasury stock is shown on the Statement of Condition as a deduction from the total stock issued, it should be shown at not less than par. No par stock should be shown at not less than the value at which issued. Any difference between the par value and the cost of treasury stock should, technically, appear on the Statement of Condition, in the Capital Surplus account. However, opinions differ as to showing Treasury Stock as a deduction from Stock Issued, and, therefore, the simpler method of stating such stock, or bonds, as an asset at cost is preferred.

Securities held in treasury should be verified by an inspection of the securities themselves, or by proper receipts, or by certification, if in other than the owners' hands. Care should be used at all times to see that receipts are genuine. In bank

examinations, always secure independent certificates and have them mailed direct to the office. This is not always practicable in commercial work, but independent certificates should be secured in all possible cases where the receipts on file do not contain a commercial seal of the holding parties, as in the case of insurance and banking departments.

Surplus.—The auditor should consider the Surplus at the beginning of the period. This item represents the accumulated profits prior to the beginning of the fiscal period under review, and should be compared with the Surplus shown on the Statement of Condition of the previous year, and with the ledger account, to see that it corresponds. If it does not, a reconciliation statement should be prepared, giving full details of the differences.

Where differences occur, or in instances where no previous audit has been made, the auditor may find it desirable or even necessary to carefully analyze the more important changes in this account for prior years.

The word surplus used without qualification means earnings available for dividends. A Surplus account composed of items which should not be used for dividends should be separated into its component parts on the Statement of Condition. Thus—Capital Surplus, Surplus by Appreciation, or other forms of Special Surplus, should be segregrated. In some states it is not illegal to declare dividends out of Special Surplus. It is, however, never good policy to do so, and the auditor should mention such practices in his report, if they occur.

Contingent Liabilities.—It is not enough for a Statement of Condition to show what must be paid; it should set forth, with as much particularity as possible, what may have to be paid. The auditor who makes a statement of condition audit must discover and report upon liabilities of every description,

not only liquidated and actual debts, but possible debts. The following are the usual forms under which contingent liabilities will be found:

Inquiry of the officers or partners of the concern should be made as to whether any endorsement of outside paper has been made and as to any security received to protect the concern. Such inquiry should be particularly strict if it is known that any of the officers or partners are interested in other enterprises.

Similar action should be taken in the matter of guaranties.

Contracts for delivery of goods contracted for before the date of the Statement of Condition, may call for the payment of large sums of money within a short time. In the case of raw materials, for a manufacturer, this might be a perfectly legitimate reason for seeking a temporary loan, pending production and sale, but for a merchant whose Statement of Condition shows a large stock of goods on hand, it might indicate a real liability impending, with assets of a doubtful character to offset it. In every audit, therefore, the auditor should call for copies of all orders for future delivery, and if such orders call for stock in excess of the current and reasonable prospective demand, mention should be made on the Statement of Condition and a report submitted, the details depending upon the circumstances.

Items other than those arising from the specfic hypothecation of current assets to be listed as liabilities should appear as a footnote on the liability side of the Statement of Condition, the total amounts being stated for each subheading and such additional report made as will convey clear information to the banker.

Wherever it is possible to ascertain the amount of a contingent liability, a note should be placed at the bottom of the Statement of Condition somewhat as follows:

"Subject to a contingent liability of $..... for endorsement or discounted notes receivable, claims, damages at law including incomplete contracts, guaranties and agreements."

Where an exact figure cannot be assigned the contingent liability, the auditor should make a comprehensive comment to that effect. Otherwise, add the sum involved to the comment or footnote as shown in the preceding paragraph.

THE BLANK COMPANY, INCORPORATED — EXHIBIT "1"
COMPARATIVE STATEMENT OF CONDITION
As of December 31, 19— and 19—

ASSETS	December 31, 19—			December 31, 19—		
Current Assets and Inventories:						
Current Assets:						
Cash in Banks		$ 88,578.67			$ 60,337.51	
Cash on Hand		1,135.00			3,355.70	
Notes and Trade Acceptances Receivable		2,865.15			2,243.50	
Accounts Receivable—Trade	$ 439,184.94			$ 480,692.00		
Less: Reserve for Doubtful Accounts	11,154.47	428,030.47		11,154.47	469,537.53	
Accounts Receivable—Personal		2,982.46			1,572.95	
—Sundry		1,388.34			30,788.78	
Life Insurance—Cash Surrender Value		67,000.00			87,900.00	
Total Current Assets		$ 591,980.09			$ 655,825.97	
Inventories:						
Goods Finished and In Process	$ 439,233.30			$ 927,487.47		
Yarn	117,966.18			88,243.93		
Silk	39,966.88			61,389.39		
Needles	10,728.36			8,506.37		
Chemicals	0.00			501.70		
Dyestuffs	0.00			849.97		
General Stores	28,583.58			41,488.49		
Packing Materials	4,479.72			4,388.19		
Boxes and Labels	15,153.42			7,552.10		
Total Inventories		656,111.44			1,140,407.61	
Total Current Assets and Inventories			1,248,091.53			1,796,233.58
Investments			80,000.00			80,000.00
Treasury Stock			10,000.00			10,000.00
Fixed Assets:						
Land		$ 35,194.69			$ 35,194.69	
Buildngs	$ 622,853.24			$ 622,728.91		
Machinery and Equipment	339,829.83			355,467.44		
Furniture and Fixtures	75,269.30			79,955.37		
Autos and Trucks	3,937.09			3,796.24		
Total Depreciable Assets	$ 1,041,889.46			$ 1,061,947.96		
Less: Reserves for Depreciation	156,855.50			205,632.15		
Net Depreciable Assets		885,033.96			856,315.81	
Net Fixed Assets			920,228.65			891,510.50

Good Will			60,000.00			60,000.00
Patents			2,500.00			2,500.00
Deferred Charges to Operations:						
Interest		$ 6,839.61			$ 1,711.02	
Insurance		10,919.36			7,518.64	
Total Deferred Charges to Operations			17,758.97			9,229.66
TOTAL ASSETS			$ 2,339,279.15			$ 2,849,473.74

LIABILITIES AND CAPITAL	December 31, 1923			December 31, 1924		
Liabilities:						
Current Liabilities:						
Notes Payable—See Schedule	$ 276,703.87			$ 215,000.00		
Accounts Payable	158,183.74			344,516.81		
Accrued—Interest	3,597.14			3,412.40		
—Taxes	5,243.50			5,697.75		
—Compensation	3,913.63			3,794.92		
Provision for Federal Income Tax	30,364.22			26,877.65		
Total Current Liabilities		$ 478,006.10			$ 599,299.53	
Total Liabilities			$ 478,006.10			$ 599,299.53
Capital:						
Capital Stock:						
First Preferred 8 Percent Cumulative;						
Authorized 10,000 Shares Par Value $100	$ 1,000,000.00			$1,000,000.00		
Unissued 3000 Shares	300,000.00			300,000.00		
Outstanding 7000 Shares		$ 700,000.00			$ 700,000.00	
Second Preferred 8 Percent Cumulative;						
Authorized 2300 Shares Par Value $100	$ 230,000.00			$ 230,000.00		
Unissued 145 Shares	14,500.00			14,500.00		
Outstanding 2155 Shares		215,500.00			215,500.00	
Common;						
Authorized 10,000 Shares Par Value $100	$ 1,000,000.00			$1,000,000.00		
Unissued 8800 Shares	880,000.00			880,000.00		
Outstanding 1200 Shares		120,000.00			120,000.00	
Total Capital Stock		$1,035,500.00			$1,035,500.00	
Surplus—See Exhibit "2"		825,773.05			1,214,674.21	
Total Capital			1,861,273.05			2,250,174.21
TOTAL LIABILITIES AND CAPITAL			$2,339,279.15			$2,849,473.74

(This Statement is subject to our accompanying comments upon the examination)

FIG. 12

If an individual or a partnership is involved segregate the capital to show:

Capital	.....	
Undistributed profits or deficit	.....	
Total	.....	
Total Liabilities and Capital	.....	$....0.00

When the Plant, Property and Equipment has been divided so that separate accounts for each asset exist, the preferred form for that section of the statement of condition is:

PLANT, PROPERTY AND EQUIPMENT

Items	Cost	Reserved for Depreciation	Net Value Carried	
Land	$.....	$.....	$.....	
Buildings	.....	.....	.....	
Etc., ...	.....	.....	.....	
Etc., ...	.....	.....	.....	
Total	$.....	$.....		$.....

FIG. 13

CHAPTER VI

STATEMENT OF OPERATIONS

Profit and Loss.—The most important function of accounting for any concern is the determination of the profit or loss. The result of operations effecting a change in Surplus must be reflected in the assets and liabilities on the Statement of Condition, eliminating dividends and special adjustments. Expenditures for capital accounts and for operation must therefore be carefully anlyzed.

The auditor should obtain the Statements of Operations for three years at least, including the period under audit, and after verifying them by comparison with the ledger account, prepare a statement in comparative form. This comparison will furnish valuable information to the banker as to the past progress of the concern under audit.

A satisfactory form of Statement of Operations is shown as Figure 14 and Figure 15 on pages 85 to 87.

While it would be impracticable and somewhat useless, in an ordinary Statement of Condition audit, to make a detailed check of all the transactions entering into the composition of the Statement of Operations account, there are certain main principles to be kept in view and they are briefly outlined in the following pages.

Sales.—Whenever possible, the quantities sold should be reconciled with the inventory on hand, at the beginning of the period, plus the production, or purchases, during the period, less the inventory on hand at the end of the period.

Where a proper cost system exists, the inventories at the beginning and end of the periods comprise only goods in process and finished stock, and the Statement of Operations should be so worded. Additions, then, instead of being purchases, are of materials consumed in the manufacture of more goods.

Where a good cost and accounting system is in force, the sales records will probably be in good shape, but, nevertheless, the auditor should satisfy himself from the shipping records that the sales books were closed on the last day of the fiscal year, and that no goods shipped after that date are included in the transactions.

When an audit is being made for the first time, the auditor should satisfy himself that the sales at the beginning of the period were recorded in accordance with the dates of shipments. Such verifications can be made conveniently by a direct comparison of the shipping memoranda with the invoices billed.

Such a comparison may also reveal the inflation of Accounts Receivable by the recording of fictitious invoices. This is particularly true of small concerns with no internal check. When such a condition is found, the verification of existing accounts receivable will establish the correctness of that portion of the sales so represented. A detailed comparison of all of the invoices with the shipping receipts, or correspondence with the customers, may be necessary to verify that part of sales not represented by Accounts Receivable. The auditor should proceed as circumstances require.

When examining invoices, note their preparation as to prices, calculations, extensions, and footings. Of particular interest is the matter of pricing—losses through application of incorrect prices, or failure to have a complete knowledge of the quantity or article invoiced, may seriously affect the profit.

Tests of a number of invoices for various periods with the corresponding price list may reveal irregular or fluctuating prices—the result of careless billing, competitive bidding, or declining values. If so, inventory valuation should be carefully scrutinized.

Allowances to customers for trade discounts, outward freights, reductions in prices, etc., should be deducted from the sales in the Statement of Operations, as the amount of net sales is the only figure of interest to the bankers.

The future bookings at the close of the fiscal year should be looked into, as a comparison of orders on hand with corresponding periods of other years furnishes the bankers with an idea of the concern's business outlook.

Proceeds from the sale of plant, equipment, land, and other items not a part of the general business should not be included as a part of the merchandise sales—they should be itemized and reported as Other Income.

Freight.—Freight prepaid on shipments to customers and deductions made by customers for freight paid by them (where the shipments have been delivered), are a deduction from the gross sales and should be treated separately from freight paid on incoming material. The former reduces the amount of the sales, while the latter increases the amount of the inventory purchases.

Cost of Sales.—The inventory at the beginning of the period, plus purchases during the period, less inventory at the end of period, gives the cost of sales. In a manufacturing concern the factory cost of production takes the place of purchases. As has already been stated, if a good cost system exists, the form of the Statement of Operations will differ vastly, for it is then possible to show not only goods purchased but also consumption. The preferred form for that part of an operations statement is briefly:

GROSS SALES					$.....
Details of allowances and deductions					.....
NET SALES					$.....
COST OF GOODS SOLD:					
Inventory beginning period of;					
Goods in process				.....	$.....
Finished goods on hand				.....	.....
Additions to inventory;					
Materials:	*On hand beginning of period*	*Purchased during period*	*On hand end of period*	*Consumed*	
(List of principal materials)	$.....	$.....	$.....	$.....	
	.....	.....	.....	.....	
	.....	.....	.....	.....	
Totals	$.....	$.....	$.....	$.....	
Total materials consumed				$.....	
Productive Labor, etc. (Detailed schedule)				.....	
Manufacturing Expense (Detailed schedule)				.....	
Total additions to inventory				.....	$.....
Total inventory and additions				.....	$.....
LESS:					
Inventory ending period of;					
Goods in process				$.....	
Finished goods				.....	.....
COST OF GOODS SOLD				.....	$.....
MANUFACTURING PROFIT				.....	$.....

Most of the items under Cost of Sales will have been verified in auditing the Statement of Condition, but, nevertheless, care should be taken to see that this heading has not been made a dumping ground for charges which would be more properly embraced under the heading of special charges. The composition of the items entering into the Cost of Sales should be traced into the cost records or accounts.

Gross Profit on Sales.—This is obtained by deducting the Cost of Sales from the Net Sales. The ratio of gross profits to net sales should be calculated and compared.

Selling, Administrative, and General Expense.—Under

these general headings should be set down the expenses, itemized to correspond with the titles of the ledger accounts kept in each division. In checking the totals of each account with the statement for the period under audit, special attention should be given to credits in these accounts to see that none have been made for the sale of capital assets and for items which should not appear in expense accounts. The percentages of the totals of each division and of the aggregate total to net sales should be calculated for each year for comparison.

Where a good cost system exists, only two general divisions of overhead expense will be found: that is, "factory" and "selling."

General expenses, after all, exist for some purpose and should be distributed to the factory or the sales department—whichever is served. This, however, can be done only when there is in operation a system showing fundamental influences upon expenses.

Administrative expense, similarly, is distributable upon analysis, for the administrative officials direct either the factory or sales policies.

Financial executives are a distributable cost, for they are needed by both of the principal divisions.

However, when a reliable cost system does not exist, set up separate headings for Factory Expense, Selling Expense, and General and Administrative expenses.

Net Profit on Sales.—This is obtained by deducting the aggregate total of the selling, administrative, and general expenses from the gross profit on sales, and shows the net earnings of the concern on its principal business. The ratio of net profit to sales should be calculated for each year in order to give comparative figures.

Other Income.—Under this heading is embraced any

income that may be derived from sources outside of sales, such as income from investments, interest, discounts, etc.

In it should also be included proceeds realized from the sale of plant, equipment, land, etc.

Schedules should be prepared of each item, and the auditor should satisfy himself of their accuracy and of the propriety of including them as income.

Deductions from Income.—Under this heading are grouped such items as interest on bonded debt, interest on notes payable, etc. The same procedure of verification as for Other Income should be followed.

Net Income—Profit or Loss.—Adding Other Income to Gross Income and deducting Deductions from Income gives Net Income or Profit or Loss for the period, which is the amount that should be carried to the Surplus account.

Surplus—Additions and Deductions.—Items of unusual or extraordinary profit which do not belong strictly to the period under audit, or cannot be said to be the legitimate results or the ordinary transactions of the concern, should be entered here and verified with the Surplus account. Deductions should be similarly treated. Also, dividends declared should be entered in the Surplus account and as an item under this caption, inasmuch as it is the usual custom to declare dividends from net earnings and surplus. After adding special credits to and deducting special charges from the net income the total profit or loss for the whole period from all sources is determined which, added to the Surplus balance at the beginning of the period, gives the Surplus at the end of the period, and should agree with the Surplus as stated on the Statement of Condition.

Unless the Statement of Operations is too lengthy, and the items of Surplus Adjustments too numerous, the analysis of the Surplus account is preferably appended to the Statement of Operations, as illustrated on page 86.

EXHIBIT "2"

THE BLANK COMPANY, INCORPORATED

STATEMENT OF OPERATIONS

For the Year Ended December 31, 19—.

Gross Sales		$2,645,683.54	
Less: Returned Goods and Allowances		97,988.30	
Net Sales			$2,547,695.24
Cost of Goods Sold:			
Inventories Beginning Period		$ 656,111.44	
Additions to Inventories;			
Purchases;			
Yarn	$ 425,390.37		
Silk	626,593.30		
Needles	14,198.76		
General Stores	45,689.28		
Packing Materials	8,969.82		
Boxes and Labels	65,733.63		
Total Purchases	$1,186,575.16		
Direct Labor	395,352.42		
Manufacturing Expense—See Schedule "B"	419,491.29		
Total Additions to Inventories		2,001,418.87	
Total Inventories and Additions		$2,657,530.31	
Less: Inventories Ending Period		1,140,407.61	
Total Cost of Goods Sold			1,517,122.70
Manufacturing Profit			$1,030,572.54
Selling and Administrative Expense:			
Selling Expense;			
Salaries	$ 26,153.08		
Commissions	191,930.52		
Traveling	25,765.38		
Advertising	76,898.85		
Branch Offices	20,586.86		
Total Selling Expense		$ 341,334.69	
Administrative Expense;			
Executive Salaries	$ 25,000.00		
Office Salaries	24,534.33		
Office Expense	23,407.16		
Legal Expense	5,403.19		
Total Administrative Expense		78,344.68	
Total Selling and Administrative Expense			419,679.37
Net Trading Profit			$ 610,893.17

Other Deductions:			
Interest Paid		$ 31,024.86	
Discount Given		90,704.34	
Bad Debts Charged Off		19,595.68	
Loss on Sales of Machinery		3,068.41	
Total Other Deductions			144,393.29
Balance			$ 466,499.88
Other Income:			
Interest Earned		$ 4,420.61	
Discounts Taken		23,059.01	
Dividends on Investments		4,800.00	
Recovered on Bad Debts		314.08	
Total Other Income			32,593.70
Net Profit for Period			$ 499,093.58
Unallowable Deductions:			
Donations		$ 1,500.00	
Reserve for Federal Income and Excess Profits Taxes		26,877.65	
Total Unallowable Deductions			28,377.65
Balance Transferred to Surplus			$ 470,715.93
Surplus Beginning Period		$ 825,773.05	
Additions:			
Refund—1917 Federal Taxes	$ 1,140.23		
Increase—Cash Surrender Value of Life Insurance	20,200.00		
Total Additions		21,340.23	
Balance		$ 847,113.28	
Deductions:			
Dividends:			
First Preferred	$ 56,000.00		
Second Preferred	17,240.00		
Common	7,200.00		
Life Insurance Premiums	22,715.00		
Total Deductions		103,155.00	
Adjusted Surplus			743,958.28
Surplus Ending Period—See Exhibit "1"			$1,214,674.21

(This Statement is subject to our accompanying comments upon the examination)

FIG. 14

In partnerships, a division of profit should replace the dividends. The partners' accounts can be shown in the following manner:

EXHIBIT

STATEMENT OF PARTNERS' ACCOUNT

For the Year Ended December 31, 19....

Capital Account of A. B.		
Balance at beginning of Period		$0.00
Deduct withdrawals:		
Personal income taxes paid	....$0.00	
Other personal withdrawals	.....0.00	
Total withdrawals		$....0.00
Balance		.....0.00
Add:		
Share of net profits		.....0.00
Balance at end of period ..... (See Exhibit "1")		$....0.00
Capital Account of C. D.		
Balance at beginning of Period		$0.00
Deduct withdrawals:		
Personal income taxes paid	....$0.00	
Other personal withdrawals	.....0.00	
*Interest on withdrawals	.....0.00	
Total withdrawals		.....0.00
Balance		.....0.00
Add:		
Proceeds of sale of securities owned by partner	$....0.00	
*Interest on additional capital	0.00	
Share of profits	.....0.00	.....0.00
Balance at end of period ..... (See Exhibit "1")		$....0.00

**Dependent upon terms of partnership agreement.*

FIG. 15

CHAPTER VII

Miscellaneous Remarks

General.—The remarks under this heading are added without an attempt to preserve the order of items appearing on a Statement of Condition or a Statement of Operations, for in some instances the remarks will apply to either, or both, or to their related schedules.

In large concerns having tens of thousands of accounts or notes receivable, the detail procedure suggested in previous chapters would be impracticable, and the internal system of checking should make it unnecessary.

In such cases only tests can be made, but the auditor must always be prepared to justify his departure from a complete program by showing that the purposes sought to be accomplished thereby have been adequately effected by his work.

Any extensive clerical work, such as the preparation of lists of notes receivable, etc., should be performed by the client's staff so as to avoid unnecessary employment of the staff in merely clerical work with consequent undue expense.

The preceding instructions present the procedure to be followed, so that the utmost security will result when the Statement of Condition is certified. When the work to be done includes the checking of all cash transactions throughout the year to guard against speculations by employees, certain added work must be undertaken.

All correspondence to verify the accuracy of the accounts and notes, both payable and receivable, and of cash in banks,

etc., serves the dual purpose of, on the one hand, proving the existence of the assets or the extent of the liabilities, and, on the other hand, of proving that money has not been received from accounts still purporting to be due.

To audit cash disbursements thoroughly, in addition to the verification of money remaining in the banks, all checks drawn throughout the year should be scrutinized and checked against the cash book or check register or voucher or charge register. Endorsements should be examined. Whether an endorsement is genuine cannot, of course, be determined at a glance; but if the checks show that they have traveled through one or more banks, the authenticity of the indorsement is fairly established by the banks' action. This precaution is necessary as sometimes checks have been drawn and canceled to hide abstraction of cash.

For the same reason cash records should be added so that false additions may not conceal losses.

All deductions not vouched for by returned paid checks must be examined.

The drawing of a check does not prove the propriety of a disbursement. A further check against dishonesty is to compare the checks, or checked entries of disbursements, with the original invoices and bills. Where such evidences of purchase do not exist, careful research should be conducted.

There have been cases of more than one check drawn to pay the same invoice, the later check being diverted.

There are also instances of invoices and checks being used a second time, a petty cash check drawn to secure funds from a bank, and then destroyed upon return of the canceled checks at the end of the month, the previously paid canceled check for like amount, with date altered, substituted therefor.

Petty officers have often purchased personal articles through company charge accounts; and particularly where the owners

are not active, executives have been known to operate automobiles, renovate homes, etc., at the company's expense on the assumption that payment by direct checks would not be detected. The auditor must, therefore, decide after studying a bill, if the purchase is in the company's interest.

Obviously, in a profession in which countless books have been written we cannot attempt to cover exhaustively all the ramifications of audits conducted under all circumstances, for the auditor must guard against every fashion of loss, ranging from the sale of unchecked materials for cash, to the taking of returned insurance premiums.

It is only by the exercise of great intelligence and by constant alertness that reasonable safety can be assured to clients.

Examined checks and invoices should be so marked, or checked, as reasonably to guard against their use in a subsequent period. The check mark should be made with "ink" or preferably a stamp bearing the auditor's name, or designation symbol, if employed by a firm. Examination of a canceled check for endorsement being the last procedure, the auditor's "tick" or stamp is frequently placed on the back of the check with the endorsements. A paid check, with an altered date, may be substituted for a corresponding invoice similarly altered, at a later period. In the interim the auditor's check mark has disappeared, or, appearing on the back of check, is easily overlooked. The auditor must guard against such possibilities. The audit stamp should be placed on the face of the check. A stamp, more easily noticed than a "tick" mark, is preferred for such purpose.

In the preceding instructions we have spoken dogmatically, but the practice as laid down is in accordance with that of the Federal Reserve Bank. But it must always be borne in mind that auditors are the client's employees. At the same time,

the auditors must be bound by the ethics of the profession, for they are to a certain extent public characters. Nevertheless, an auditor cannot prosper if he affronts clients, and even when sent to make an examination of a third party's affairs, can suffer by overinsistence.

It is not the duty of an auditor to search out economies for a client, unless, of course, the agreement stipulates that more than a mere audit is to be performed. On the other hand, the auditor's examination may very likely reveal economies which may properly be discussed with the client, or even on occasion be included as a part of the comments on the audit. For example, examination of the manufacturing expense may indicate excessive stock with a declining market, or bring to light expenditures for labor, repairs, water, heat, light, power, supplies, insurance, etc., which from the auditor's experience are excessive or unnecessary. Charges to Selling Expense when subjected to a careful scrutiny may prove to have been unauthorized or unwarranted.

An examination can be carried only as far as the client will permit. A client's decision not to permit correspondence with his debtors to verify his Accounts Receivable may not mean that the accounts are of questionable value. The client may believe the expense of the effort to be unjustified; may not want to risk misinterpretation by stirring up his customers, may have other good reasons for limiting the work. These limitations must be accepted gracefully, and without suspicion, if they originate with the proper authorities of the client's company.

Some clients do not gracefully accept a criticism of the operations. Others do not wish to incur the expense for a comprehensive analysis of the revenue and expense items, so far as the internal policies of administration are concerned. Again, a client may be quite willing to discuss such matters

with the auditor, yet not wish to have them embodied in a written report for publication. When a client is willing that comment on the operations be embodied in the report, a candid statement of what has taken place, without remark as to the wisdom of the policy pursued, is all that is necessary.

In the comments attached to the report, however, heed must be given to the public character of the work, by stating the extent to which it has been carried.

This will serve a warning to bankers and others reading the statement, so that, if they are not satisfied with the extent to which the examination has been carried, they can urge or instruct the client to permit further investigations.

In every event, before work is undertaken, the printed program reproduced on pages 4-11 should be studied and amplified to suit the needs of the current situation. Upon the presumed completion of the work, the situation should be reviewed and omissions sought.

Agreement for the Sharing of Profits.—Agreements between managers, superintendents, or other employees of concerns, as to extra compensation in the form of a percentage on the gross sales or net earnings of a business, should be examined (in the case of a corporation, such agreement to be effective should usually be recorded in the minute book) to define the proper method of arriving at such division of profits. An immediate factor in defining the cost of operation under such arrangement is the interest on the capital, which should be added to the ordinary expense.

Partnership Agreements. — Partnership agreements should be examined to verify the basis of arriving at the proper division of profits. The capital accounts of partners should be analyzed for the full knowledge that the respective accounts show only the investment contributed as such, and not other items, such as money borrowed from the outside,

upon which the interest is paid by the firm. Such items should be deducted from capital accounts and shown as Loans Payable.

Operating charges should not be entered in partners' drawing accounts, or applied as a reduction of their capital accounts. It will be seen that should partners desire to show inflated profits for any period, for the purpose of disposing of the business advantageously to themselves, they could, by charging costs of conducting the business to their capital accounts, make an excessive showing of the profits of the business.

Interest Charges Between Partners.—If an interest agreement exists in a partnership providing for unequal capital invested, and interest in the business is share and share alike, the interest chargeable against the partner having the smaller amount of capital may be subject to the provision of a partnership contract or agreement.

Anticipated Profits.—Charges against customers, which are treated as accounts receivable, can only be for goods delivered or services performed; in fact, earned income. Charges should not be made for unexecuted contracts or orders as shown on hand, unless the cost of the unexecuted contract or order is shown at its full present and prospective liability.

As already stated, inventories should always be presented at a live inventory cost price. Should an inventory be taken at a selling price, it would have the effect of anticipating profit.

Sales and Purchase Ledger Balances.—These balances, in a Statement of Condition, should show the gross amount of both the debit and credit columns, instead of the net amount. In other words, the aggregate balance due from customers, whether or not shown by general ledger con-

trolling accounts, should not be shown under Accounts Receivable as net. Credit balances should be included in the current liabilities, and classified as Credit Balances on Accounts Receivable. The aggregate balances of creditors' ledgers should likewise be shown separately, the debit balances being included in the Current Assets and classified as Debit Balances on Accounts Payable. Whenever possible, the auditor should correspond to verify correctness of items shown due to or from creditors and debtors. When this is not permitted the lack of such verification should be commented upon.

Insurance.—If such materials as tobacco, sugar, hemp, chemicals, etc., are used, where yearly policies of insurance are written on merchandise in warehouse, which is subject to consumption, an examination of all canceled policies should be made to verify the proper returns on cancellation.

The auditor when analyzing the insurance account should satisfy himself that a reasonable amount of insurance is carried for the client's protection. Likewise he should satisfy himself that insurance premiums are not being paid for property not requiring insurance. The form of insurance carried and the need for that particular kind of insurance should be given careful consideration. Insurance may be carried that is not needed, or insurance may be needed and not carried. As an illustration, a dress goods store paid a substantial premium for insurance against possible water leakage from upper floors. Their goods were displayed in cabinets raised several inches above the floor. It cost but a small sum to waterproof the tops of the cabinets, effectively preventing water from getting inside, thus eliminating all necessity for that particular kind of insurance.

A client is usually glad to have a lapsed insurance policy brought to his attention by the auditor.

Surety Company Cases.—When notified of a loss, the first thing to do is to visit the surety company requiring service and obtain a copy of the policy, with all riders attached, and any further information in regard to the insured, the loss, or the detective's report. The claimant should then be visited immediately, all of his books stamped or initialed and numbered and a list of them taken. Notes should be taken regarding any inventories, which he has; detail regarding the company—its business, volume, names of partners, managers, and bookkeepers.

Any wrappers, boxes, or visible evidence of loss should be marked and a list taken of them, and the claimant should be told not to destroy these until the claim has been settled.

In fact, get all the preliminary data and notes having a bearing on the work, but do not do any of the work until the claimant has submitted his proof of loss. It is well to have him state the approximate amount believed lost.

Employees' Fidelity and Benefit Funds.—Amounts deposited by employees fidelity funds and amounts deducted from wages to maintain sick and accident benefit funds should be presented as a liability under the caption of Trust Funds.

CHAPTER VIII

Work Reports—Manuscript Reports—Finished Reports

Work Papers.—The accumulated data, or work papers, form an important part of an auditor's work. From them the final or manuscript report is prepared. Conditions nearly always arise which necessitate reference to work papers. It may even be necessary to produce the work papers in court, or to secure data therefrom for the client. It is therefore essential that the work papers be preserved in a neat and orderly condition. Work papers should be carefully assembled, properly indexed for reference to the data therein, and bound to maintain their preservation. The examination program shown as Figures 1, 2, 3, and 4 is designed to serve as a binder for the work papers as well as for a record of the history of the examination. Both are an integral part of the work and the folder retains them.

The form illustrated is 8½" x 14", the size of the auditor's analysis paper. It is sufficiently adjustable to retain the work papers of the usual audit, and is punched on the second sheet for use of fasteners. The analysis paper is similarly punched for use of fasteners. If the work papers are voluminous, as many covers as are necessary can be used. In that event they should be properly numbered and their contents noted on the form. Another advantage obtained by the use of this form is that the auditor constantly has with him instructions as to the method of assembling and indexing the

work papers, thus standardizing the method of filing, either for himself or the firm by whom he is employed.

The following instructions as to preparation and preservation of work papers are important:

The work papers of an audit or investigation form an important part of the work. They should be neatly prepared and carefully kept. They should show a complete detail of all items in the accounts that have been examined, and should indicate (a) methods of verification used; (b) questions brought up during the examination, the disposal thereof, and name of the representative authorizing any arbitrary handling of the accounts.

Where conditions arise that vitally effect an audit from year to year, and where work done is likely to become, or already is, a regular audit, the senior accountant in charge should separate from the work papers all documents of recurring utility, such as copies of certificates of incorporation, trust deeds, long-term contracts or agreements, abstracts of the minutes, etc. Such papers should be separately bound, plainly marked "permanent file" and placed in the current file.

This form is to be used as the outside cover for the work papers which are to be assembled, under the direction of the senior, in the following order:

1. Index of work papers
2. Trial balance
3. Adjusting journal entries
4. Schedules, analyses, and notes, in trial balance sheet order
5. General remarks and notes.

All work papers are to be arranged in the order in which the subject appears on the trial balance sheet, and each page is to be numbered at the bottom of the sheet. An index is then to be prepared listing each sheet, or group of sheets

comprising a subject, the index to give the page numbers. This index is to be placed first as noted above.

All adjusting journal entries shall be numbered, and a corresponding number shown after each item on the trial balance sheet for which an adjustment is made. The number on the trial balance sheet is to be "circled" to prevent any misinterpretation of figures, and as a means of ready reference.

After work papers have been properly arranged, they are to be carefully fastened together with fasteners and placed in a large envelope, together with the manuscript of the report itself, which is to be typed or printed. Any notes on memoranda too small to be properly fastened should be pasted to a work sheet and the sheet then properly inserted in the cover.

Write plainly.

All work papers should be returned to the office as soon as an engagement has been completed. Frequently errors in reports are discovered when the results are in the office. If the work papers are not immediately available, errors cannot be traced and corrected.

It is also suggested that reports, when finished in the rough, be surrendered as promptly as possible to the office, even if it is known that no work can be done upon them for some time.

It is especially important that all figures and letters be written distinctly so that they will be legible to the accountant or to anyone else.

Do not use ink in preparing work papers, as much erasing is bound to be necessary.

When more than one accountant is working on an assignment and there is occasion for a distribution of the analytical work, etc., then the individuals should initial their papers so that the office can ascertain the responsibility, if necessary.

All working papers should be of uniform size. It is advisable for the accountants to use nothing but standard size blocks of scratch paper for all of their memoranda. Use only one side of the sheet as the writing on the back of the sheet may be overlooked at a critical moment.

During the preliminary stage of the examination the accountant should acquaint himself with the system of accounts upon which he is working. It is essential that he have a list of all the books and records that are examined.

When analyses, etc., are made on separate sheets they should be properly marked by letter or number so they can be readily found on the working sheet.

Any adjustment that the accountant may be called upon to make should be recorded in journal entry form as though the entries were made on the books.

It is also advisable to incorporate these entries, when sufficient in number, into a schedule making them a necessary part of the report.

Manuscript Reports.—The manuscript is simply a preliminary draft or rough copy of the report to be finally printed or typed for the client. Incompleteness or carelessness in grouping figures, terminology of accounts, indefiniteness of expression in the comments, are magnified many times in the final report, and must be effectively guarded against. The thoroughness of the whole audit may be said to be summed up in the final report to the client.

Assembling the accumulated data from the work papers to the Statement of Condition and Statement of Operations, with their supporting schedules, must precede the preparation of the finished report. The assembling of such data requires the thoughtful effort and technical skill of the auditor. Its preparation should be free from the possibilities of mistaking figures, letters, names, and set-up or grouping of accounts.

While the finished report is in reality a copy of the manuscript, nevertheless, the manuscript should be retained and finally filed with the work papers. Where an office force is maintained the manuscript must pass through certain routine handling before the printed or typed report is complete. For the purpose of keeping the manuscript intact for the auditor's use, for office purposes, and for final filing, a folder, similar in size and design to that provided for work papers will be found satisfactory.

The first sheet of the folder provides space for insertion by the auditor of information needed by the office, i.e., client's name, address, period covered by the audit, number of copies of the report desired by the client, whether to be printed or typed, and the person to whom the finished report is to be delivered. In addition there is also printed on the first page of the folder brief instructions as to the manner of assembling the manuscript data. The second page contains a sample form of a Comparative Statement of Condition, as shown in Fig. 12, page 76 and the third page a form of Statement of Operations, as shown in Fig. 14, page 85. Just as the examination program provides a desirable folder for the assembling and filing of work papers, so the manuscript report folder provides for the manuscript data. The two should finally be filed together.

The instructions contained on the manuscript folder are as follows:

Manuscript reports reflect the auditor's synopsis of the examination made, and form the first step in the preparation of a finished report for the client. This part of the report should be carefully and thoughtfully prepared, and due consideration given to that which is essential and of importance to the client. In preparing the report there should be considered the size of the business, the familiarity of the client

with accounting methods, and the purpose or object of the audit.

The comments should not be too brief, nor too long. They should be sufficient to portray what the account means, what has, or has not, been done to verify the account, and sufficiently devoid of technical terms to be readily understood.

All items of consequence, and inconsequential items not made clear by their own designation, on the Statement of Condition shall be commented on in the order shown in that Statement.

The printer, or typist, not being an accountant, cannot be relied upon to produce from poor copy the correctly related values of headings and spacings, nor interpret careless writing.

The first page of a report is to be the letter of transmittal and indicate reference to the statements contained in the report, and be followed by the signature.

In addressing the report the "Mr." should be omitted when the title of the recipient follows the name. Names of persons or firms should be written in full and not abbreviated.

The name of each account in the "comments" is to be followed by the amount of the account as shown on the Statement of Condition—thus "Cash $..... Accounts Receivable $.....

When preparing extra large reports, or making an unusual examination or audit, such as may arise from a special investigation, or the absence of an audit, the comments on the accounts may be preceded by an historical narrative of the business, showing incorporation, product manufactured, location of plant, predecessor, stock issued and outstanding, etc. This could then be followed by a résumé of the financial position and a synopsis of operation for the period covered by the examination.

A skeleton form of "Statement of Condition" and "State-

ment of Operations" is hereafter shown to illustrate the desired set-up, capitalization and marginal spaces. The arrangement must be considered flexible, for each case will have to be treated according to its separate requirements. The forms will simply serve as a general outline.

The terms, "Balance Sheet" and "Profit and Loss," while not incorrect, are not to be used; "Statement of Condition" and "Statement of Operations," respectively, are the designations to be used.

The dollar sign ($) should be placed at the top of every column of figures, whether there is one figure or a number of figures in the column.

The asterisk (*) used to show loss or gain, or other reference, should be placed at the right of the figure where it will not conflict with the dollar sign.

When compiling comparative data and there is no comparative figure for any item, three ciphers should be used in the blank space—thus 0.00—clearly denoting no omission of figures. On Comparative Statements the current period should be first shown—thus 1926, 1925, 1924, 1923.

Underline each column of figures, or subdivision, by a single line, or a double line, as it should appear on the completed report.

The use of capital letters in Statements requires careful attention. The main heading should be written with each word capitalized; however, the second line of the main heading should have only the first word and nouns capitalized. The words "and," "of," "to," "for," etc., appearing in the designation of accounts, should not be capitalized. Only nouns and proper names should be capitalized in tabulation.

Statement of Condition and Statement of Operations are to be numbered respectively "Exhibit 1" and "Exhibit 2."

Any schedules to substantiate detail shown thereon are to be designated as "Schedule "A," "B," "C," etc.

The sentence "This Statement is subject to our accompanying comments upon the examination" should appear on the Statement of Condition and Statement of Operations, except where comments are not made.

It is a good plan to get information pertaining to tax needs on both statements. The Work Papers should show the segregation of taxable and non-taxable income from Bonds, Stocks, and Mortgages, etc., and should have a schedule supporting the charge for Depreciation and show the reconciliation to the amount of the Reserve on the Statement of Condition. They should also contain analyses of the Interest Account, Loss on Bad Debts, Gain on Sale of Capital Assets, etc., which are important for tax purposes.

Finished Reports.—The character of the reports an auditor renders is of unusual importance to the preservation of his reputation and the continuation of his work with any client. To the ordinary prosperous client—and one seeks particularly to serve prosperous clients—business events follow so rapidly on each other's heels, that the details of the work performed by the auditors soon fade from mind. The reports, however, are kept for years, and may often be referred to. Moreover, though only one or two officers or principals of a business enterprise are apt to come in personal contact with the auditors, the reports may be sent to a great many stockholders, directors, and banks.

Ordinary business documents, such as letters, telegrams, etc., are given passing scrutiny and are then generally lost in the files. Auditors' reports travel from hand to hand, and are subjected to minute scrutiny by many competent men. Aside from the clients' executives, who are usually better acquainted with the affairs described than the auditors, the reports are

analysed by bankers, note brokers, and internal revenue collectors, many of whom are your equals in accounting practice.

Because of this possible circulation of reports, the most carefully performed audit, that should redound to the auditor's credit, may instead bring ridicule upon him through small errors in the figures of a report, or through the careless phrasing of the comments of a report.

Reports must therefore, be not only arithmetically correct, but care must be taken to provide proper and informing titles of account, to group related figures, and to check all references and accounts, so that they will tell a consistent story. Undesirable exceptions to this policy are repeatedly observed. One report, the writer recalls, gave different inventory figures, for the same date, in the Statement of Condition and Statement of Operations. The accountant's explanation was that the Statement of Condition total was the aggregate of all inventories, while the Statement of Operations carried a part in the closing of the section entitled "cost of goods sold," where the inventory at the end of the period was deducted, the balance having been deducted from various figures before they were used, such as coal, to provide a "coal consumed" figure, etc. Though explainable, such a report is not accurate or logical save where titles and differing figures are so shown that the connection can be traced.

Similarly subject to suspicion by an outside reader was another report giving depreciation deducted on the Statement of Operations as approximately $110,000, but speaking in the comments of depreciation taken as $112,000. The difference was found to be branch office furniture depreciation and charged into selling expense. The charge is properly a selling cost but the report was given the appearance of error, by conflicting and unexplained figures.

The wording of the comments is of unusual importance.

The average accountant is not a fluent writer, and repetition of stock phrases tends to deaden the importance of careful work. The natural result is an undesirable shortening of necessary paragraphs or the omission of vital statements.

Section 2 of this book contains a number of standard paragraphs. The language in them has been carefully chosen and every effort has been made to make the comments complete.

Promising Reports.—It is not well for accountants to specify dates for reports without first consulting the office. Unpleasant experiences sometimes occur with clients on this score, and clients are too often lost because of a report which was delayed of necessity beyond the promised date.

Completely typed reports or printer's proofs must be compared word by word and figure by figure, initials of both comparers being added, when the report is corrected.

Then to provide against careless comparing or accounting errors, all subtractions, additions, and divisions must be refigured, when arranged both horizontally and vertically.

Lastly, the report is bound, a registry number is applied by pasting a numbered seal to the title-leaf, preceding the introductory letter, and the number and name of client entered upon a register. The report is then mailed either "special delivery" or by registered mail.

Care of Audit Data.—Auditors and their assistants, accustomed to a voluminous detail of statements around them, become so careless as to permit work papers and other valuable data to lie around readily accessible to anyone who may care to see or use them. This is especially true during the luncheon period or overnight. It is not unheard-of for work papers to be altered during the auditor's absence, the alteration not detected, and an incorrect report rendered. The auditor will find it a good plan, when working on engagements where it is known, or even suspected, that irregularities exist,

to guard against work data getting into the hands of unauthorized persons, particularly so if the person suspected of irregularities is still in the client's employ. The auditor must also take ample precaution to protect brief-cases from being stolen either while at a client's office or en route to and from the engagement. The same degree of care should be used in protecting the property of a client. Where statements are used for comparative purposes, the client is naturally indignant in having them covered with pencil marks and other notations, and still more indignant when the auditor fails to return them. Canceled checks, notes, and other data should be returned to the person from whom borrowed. It is a good plan for the auditor to obtain a receipt upon the return of such data. It does not indicate an orderly trend of mind for an auditor to leave checks or other papers lying around when he makes his departure. The auditor's prestige is subsequently lessened when the client has urgent need of data, known to have been used by the auditor, and then found to be missing.

SECTION II

STANDARD PARAGRAPHS FOR AUDIT REPORTS

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CHAPTER IX

Introductory Letter—Form of Certificate

Introductory Letter.—The principal exhibits and introductory letters have been so standardized by custom as to make their use in a given manner almost mandatory. There are many forms and styles in which the report may be presented, and every auditor or audit firm will naturally adopt the style and form that suits its individual taste.

One way is to consider all of the comments on the examination as the letter to the client. A better way is to make the first page the introductory letter, relating therein the period of the examination, listing of the exhibits contained in the report, with the signature of the auditor, or audit firm, affixed in the usual manner. In that case the comments follow as part of the report proper.

The following form of introductory letter will be found satisfactory for the usual audit examination not requiring a certification.

Introductory Sheet for the Usual Commercial Examination

Dear Sirs:

In accordance with your request, we have made an examination of the books and accounts of ..... for the period from ..... to ..... (or for the year ended.....).

The result of this examination is presented in the following exhibits and their related schedules:

Exhibit "1"—Statement of Condition as of .....

Exhibit "2"—Statement of Operations for the period from .....to.....(or) for the year ended.....
Schedule "A"—Accounts Receivable
Schedule "B"—Securities Owned
Schedule "C"—Manufacturers Expense.
(Other Schedules as needed)

The scope of our examination, together with our comments thereon, is set forth in another part of this report.

Very truly yours,
By _____
C. P. A. (and other degrees, or membership)

Form of Certificate.—It is preferable that the certification of a complete audit be embodied in the introductory letter. Whether the certification is included in the introductory letter or on the Statement of Condition, any comments or reservation of the auditor's responsibility, qualification of the accounts, or reference to any facts should be so correlated as to insure one not being used without the other. An effective means of accomplishing this is a reference on the Statement of Condition and the Statement of Operations that they are subject to the accompanying introductory letter, comments, or exhibits. For that purpose it is customary to include on those statements, in such manner that it cannot be cut off without destroying the completeness of the statements, the sentence "This statement is subject to our accompanying comments upon the examination" or "This statement is subject to the remarks contained in our introductory letter."

An introductory letter with a form of certificate is given below:

INTRODUCTORY LETTER AND CERTIFICATE FOR THE USUAL COMMERCIAL EXAMINATION

Dear Sirs:

In accordance with your request, we have made an examination of the books and accounts of.....for the period from .....to.....(or for the year ended.....).

The result of this examination is presented in the following exhibits and their related schedules:

Exhibit "1"—Statement of Condition as of.....
Exhibit "2"—Statement of Operation for the .....
Schedule "A"—Securities Owned
Schedule "B"—Accounts Receivable.

We certify that, subject to our accompanying comments, the statement of condition and related statement of operations, presented herewith, correctly set forth the financial condition of the company as of ..... and the operations for the period stated, and are in accordance with its books and accounts as at (the date of Statement of Condition).

Very truly yours,
By _____
C. P. A. (and other degrees)

The introductory letter, comments, and statements are bound in one cover, and the absence of any one when the report is examined will arouse the reader's suspicion.

While there are many forms in which a certificate may be given, each of which will convey a different idea of the extent to which the auditor assumes responsibility for the audit, nevertheless, the above form for a complete audit certification will be found, generally, satisfactory. More frequently the client will desire only a certified Statement of Condition, briefly and concisely given. If the audit has been complete and a satisfactory examination made, the certification on the Statement of Condition may be in the following form:

We certify that the above statement presents the condition of
JOHN BLANK & COMPANY
as of
(Date)
in accordance with its books and records, and it is our opinion

that this statement correctly sets forth the company's financial condition as of the date indicated.

(Audit Company)

By _____

An auditor should always assume that a Statement of Condition prepared by him may be used for the purpose of obtaining credit. For this reason the wording of a certificate appended to, or made a part of, a statement is of the utmost importance. As previously mentioned, it should be as short and concise as possible, considering the facts. Whenever possible the auditor should see that any adjustments he may make are recorded on the books, preferably by the client, so that he may note in the certificate that the books are in agreement with the statement as rendered. If the auditor finds that he cannot give an absolutely unqualified certificate, he should qualify it, both to prevent misrepresentation and to protect himself. As an example, it rarely happens that an auditor personally takes the physical inventory and prices the articles. If, therefore, he is not certain that the inventory figures shown on the Statement of Condition represent the facts, he should so state in his certificate. This may be accomplished by inserting a clause such as "subject to inventory taken and priced by officers (or employees) of the company," etc.

It should also be borne in mind that a client usually presents an auditor's statement to a banker without the accompanying comments. If there are so many exceptions or qualifications mentioned in the comments that they cannot be included in a qualified certificate, it, as mentioned previously, should contain a reference to the audit with the sentence. "This statement is subject to the comments contained in our audit report upon the examination." The auditor must always be on his guard to avoid any possible misrepresentation in either

form or intent of the certificate. If any qualifications of the audit are necessary, state them clearly and concisely.

Report Comments

Standard Paragraphs.—Standard paragraphs are desirable for two purposes; first, to save time for accountants in writing the comments of a report, and second, to make sure that each comment will be accurately and clearly expressed.

It is obviously impossible to write beforehand paragraphs which will cover every conceivable comment. The attempt has been made, however, to cover all of the usual ones. The auditor is expected to use such of these as fit and then to write such other paragraphs as the special case calls for.

As requested, we undertook to verify the accuracy of the assets and liabilities carried on the books of account and to certify that all assets owned by the company are presented at a true "going concern" value. All valid ascertainable liabilities are correctly included in our Statement of Condition. We recite below the extent of, and relevant comments upon, the various phases of our examination.

Fixed Assets.—This series of paragraphs may be used under any of the following captions: "Fixed Assets," "Plant and Equipment," "Land, Buildings, and Machinery," "Land, Buildings, Machinery and Equipment."

These assets are carried on the books at original cost with offsetting reserves for depreciation to provide for wear and tear and obsolescence. On the Statement of Condition we have applied the reserves for depreciation against the respective costs and extended the net book value as the asset value.

Upon reviewing all charges to these accounts during the period covered by our examination, together with all vouchers

supporting such entries, we found that none but capital expenditures were included.

By carefully scrutinizing all charges to these accounts during the period under review, it was determined that no items properly chargeable to operations were included.

Under this caption on the Statement of Condition, we have set forth the cost values carried in the ledger for the respective accounts, applied against them amounts set up as reserve for depreciation and carried the balance out as the net book value. All charges to these accounts during the period were supported by properly authorized invoices of the vendors. No items properly chargeable to operations were included.

There were charged to your operating accounts, and credited to reserve for depreciation account, amounts which in our opinion, adequately cover wear and tear and obsolescence for the period.

We strongly recommend that your reserve for depreciation account be analyzed and the amounts reserved for depreciation of different classes of assets (such as buildings, machinery, etc.) be set up in separate reserve accounts.

This practice would permit the ready determination of the net book value of any class of fixed asset at any time. Furthermore, the regulations and rulings of the Commissioner of Internal Revenue require that such information be available for the correct preparation of Federal Tax Returns.

The following amounts credited to reserve for depreciation accounts, and charged to operations for the period, represent

the stated percentages of the cost of the respective depreciating assets:

Asset	*Percentage of Cost*	*Amount Reserved for Depreciation*

We believe the amounts so reserved to cover wear and tear and obsolescence for the period are (adequate—inadequate).

The deeds to your property, together with the County Clerk's certification that proper recording had been made, were examined and found to be in order. We also examined, and found satisfactory, title insurance policies covering the property.

We have shown the value of land and buildings separately on the Statement of Condition. Buildings depreciate in value through wear and tear but plant land does not. The true book value of the depreciating asset is more readily ascertained by separation of the accounts and application of the reserve for depreciation against the account affected. We recommend that the land and buildings account be separated on your books.

During the period under review additions to your fixed asset accounts amounted to:

Asset	*Amount* (List amounts without consideration of reserve for depreciation)

All of the entries covering these increases were carefully scrutinized, together with the vouchers supporting them, and found to be capital charges.

The reserves for depreciation were increased by the amount of $..... during the period. The following are the yearly rates of depreciation applied and the amounts set aside as representing the wear and tear and obsolescence for the year for the respective classes of assets:

Asset	*Yearly Rate*	*Amount Reserved for Depreciation*

These entries resulted in a net (increase—decrease) for the period of $..... in the net book value of your fixed assets. We believe that the amounts reserved for depreciation adequately cover the wear and tear and obsolescence of your properties.

The scope of our examination precluded analysis and verification of all entries in your capital accounts from the date of their inception. We believe, however, that the values carried reflect the cost of the original properties and subsequent additions.

An appraisal of your properties by ..... (Name) ..... under date of ..... (Date) ..... affords the following favorable comparison of current replacement values with the net book values as of .....(date).....

Asset	*Replacement Value*	*Net Book Value*

As the difference between the appraised value and the net book value represents an unearned increment, and good accounting practice precludes its recognition as a profit of the business, the Statement of Condition reflects the net book values only.

We note with approval that you have not carried into your books of account the value placed upon your properties by ..... (Name) ..... in an appraisal dated..... The comparison between the appraised value and the net book value is favorable to your company. Good accounting practice, however, precludes recognition of a profit until a sale is made. An enhancement in value indicated by an appraisal should be recognized chiefly for insurance purposes but should not be reflected on the books of account. We show below a comparison of the appraised values with the net book values as of.....(Date) .....

Asset	*Replacement Value*	*Net Book Value*

To be used for special investigations only:

We recommend that you discontinue the present practice of writing down the value of your depreciable assets by the amount of depreciation charged to operations. You are using fixed annual depreciation rates against the balances appearing in the accounts, which results in a smaller proportion of the original cost being written off each year. The best practice requires that the original cost of the assets be retained in the accounts while the yearly depreciation provision is credited to a reserve for depreciation. Under this practice the reserve for depreciation would be sufficient to amortize the original cost of the asset completely at the expiration of its estimated life.

We examined the deed to your property and found in the County Clerk's certification that proper recording had been made in the name of your institution. We also found that you are protected by a title insurance policy.

Investments.—We examined, and found in order, the securities carried in your Investments account. Your Income account reflected proper credit for interest and dividends earned during the period. Interest accrued but not received at the date of closing is carried as a current asset. Note—If the securities were all bonds or all stocks, changes should be made in the above paragraph accordingly.

The securities are carried on your books at cost. We have not made any adjustments to bring the book value into agreement with current market values, although, as indicated on Schedule ....., a (profit—loss) would result from the sale of the securities. Federal Tax Law Regulations do not recognize a profit or loss on securities until a bona fide sale is made. This is in agreement with good accounting practice.

Accounts Receivable.—A listing of the balances appearing in the individual accounts proved the accuracy of the amount shown on the Statement of Condition. We did not correspond with your debtors for the purpose of verifying the amounts shown to be due from them. By thorough tests of postings from books of original entry affecting accounts receivable, we established the clerical accuracy of the accounts.

By the time our examination was completed, substantially all of the accounts open at the close of the period under review had been paid.

We noted, however, that after payment by the debtors, small balances remained in several of the accounts. In the majority of instances they represent items in dispute, such as claims, returns, or cash discounts.

We suggest that a member of your staff be assigned to the duty of taking these items up for adjustment and write off the accounts which do not reflect a possibility for collection.

We investigated these exhaustively and found them to be in good condition. Aside from listing the detailed accounts and proving against the total shown on the Statement of Condition, we prepared and mailed statements to all debtors with a printed inquiry, so worded that we would be advised of any discrepancies through our own office. The exceptions taken were few in number and consisted of only the customary questionings of trifling claims, discounts, and other items of the type frequently disputed.

Any necessary concessions will, we believe, be adequately covered by the reserve for bad debts established.

We proved the accuracy of the amount shown on the Statement of Condition by listing and totaling the detailed accounts. A thorough test of postings from the books of original entry was made. We did not, however, correspond with the debtors to verify the authenticity of the accounts.

Except for the items listed in Schedule....., the accounts were all of recent origin.

From the tenor of replies to inquiries directed to your debtors, requesting verification of the balances shown on your books, we believe your records correctly reflect the trade accounts receivable. The minor exceptions taken represent chiefly claims, discounts, and similar items commonly in dispute.

We carefully examined the detailed accounts and found them to be in good condition. The comparatively few past due accounts indicate care and conservatism in the extension of credit.

A listing of the balances appearing in the detailed accounts and exhaustive tests of postings from books of original entry revealed no discrepancies and assured the clerical accuracy of the work.

We did not, however, verify by correspondence with the debtors the balances carried on the books.

We found numerous small credit balances appearing in your accounts receivable and have set them up as liabilities on our Statement of Condition. We believe it to be good practice to clear these items periodically by remitting amounts standing to the credit of customers.

On Schedule.....we have classified your accounts according to the length of time they have been on the books. Although some of them are past due we believe them to be good and do not feel that you would be justified in writing them off.

Accounts amounting to $..... were written off to profit and loss during the period. We found that every reasonable effort had been made to collect those accounts. The amount, however, is but a small percentage of your sales for the period, which indicates care in the extension of credit. Accounts past due, but considered good, were being followed up vigorously for collection.

Notes Receivable.—We examined the notes represented by this account and found the total to be in agreement with the amount shown on our Statement of Condition after considering the notes paid during the period between the date of the statement and date of our visit.

The notes representing this account were examined and found to be in order. We are attaching a schedule of the notes as part of this report.

In support of the amount shown on the Statement of Condition, we are attaching a schedule of notes receivable. Notes maturing between the date of our Statement and the date of our visit were checked for cash receipts or renewals. The balance of the notes were examined and found to be in order.

Notes maturing after the date of the Statement and prior to our visit were checked for proper cash receipt. We obtained acknowledgement from your banks that the balance were in their hands for collection.

The notes represented by this account matured and were paid between the date of our statement and the date of our visit.

We have verified the balance representing this account. Notes maturing between the date of the Statement and the date of our visit were checked for cash receipt or renewal. The remainder of the notes were examined and found to be in order, excepting those in the hands of your bank for collection. In verification of the latter we obtained an appropriate certificate from the bank.

Inventories.—The values stated in the Statement of Condition represent inventories taken by your representatives as of the close of the period. After carefully testing prices, footings, and extensions to assure ourselves of the clerical accuracy of the work, we accepted the figures.

As we were not represented at the time the inventories were taken, we had no opportunity to verify the count. We did, however, test the prices applied to the major items listed, together with extensions and footings, and assured ourselves of the clerical accuracy of the inventories.

We have accepted the inventories prepared by your staff. The extent of our verification was to test the prices, extensions, and footings appearing on the inventory sheets. We in that way satisfied ourselves as to the clerical accuracy.

We were not represented at the time your inventories were taken but accepted your figures after exhaustive tests of the extensions and footings. We also tested the prices applied against the major items and found them to compare with market values as of the date of the inventories.

On.....(Date)..... physical inventories of the raw material, goods in process and finished stock were taken, together with an inventory of the other supplies. We assigned.....(Number)..... representatives to aid in the actual count and tabulation of the articles. .....(Number)..... of those representatives, to whom we assigned the more difficult tasks, have been for years intimately associated with the industry

Pricing was done at cost or market, whichever was lower in each case. Goods in process and finished goods were extended at conservative cost figures The mathematical accuracy of extensions and footings was thoroughly tested.

Our representatives were present at the time the physical inventories were taken and assured themselves of the accuracy of the count by thorough tests. The extensions and footings were also carefully tested. We, accordingly, believe that the figures stated correctly reflect the value of the inventories as of the date of our statement.

Note—Indicate when using the following paragraphs whether the singular or plural form of "bank" and "depositary" is to be used.

Cash in Bank.—After taking into consideration all outstanding checks, we reconciled your cash account with the balance certified to by your depositary. All checks were examined for proper endorsement and checked into the books of entry.

We secured from your depositaries, certificates of balances as of.....(Date)..... which, after deduction of outstanding checks, reconciled with your cash account. All canceled checks were scrutinized as to proper entry and endorsement.

We obtained certificates of balance, as of the date of our Statement, from the company's depositaries, which, after considering outstanding checks, we found to be in agreement with the records.

Statements were received from your depositaries certifying to the balances on hand to your credit as of..... (Date)....., which after consideration of outstanding checks, agreed with the ledger accounts.

Petty Cash.—The cash and vouchers on hand at the time of our visit proved to be in agreement with the records.

Our representative counted the cash and vouchers on hand and found the total to be in agreement with the ledger.

This was counted by our representative, and, after consideration of unentered receipts and disbursements, the balance agreed with the amount shown on your records.

We suggest that the "imprest cash" system be adopted. An amount sufficient to cover requirements for a period should be charged to the cashier and he would be required to have that amount in cash or cash and vouchers on hand at all times. The fund should be reimbursed by the actual amount of disbursements as occasion may require.

It was found that receipts from cash sales were passed through your petty cash. We suggest that such receipts should be credited through the regular cash book and deposited daily with other cash receipts.

Sinking Fund.—The provision of your..... (Name and indenture)..... requires that a sinking fund be provided as of.....(Date)..... sufficient to purchase and retire each year..... (Amount)..... of ..... (Indenture) ....., to be purchased in the open market, or selected by lot, at not more than $.....

Our examination reveals that the provision of..... (Indenture)..... has been complied with and that funds in the amount of $..... are on deposit with ..... trustee of the sinking fund.

The funds on deposit with the trustee are sufficient to retire the amount of $..... of.....(Indenture)..... for the period ended..... Your trustee has acknowledged the amount of funds on deposit, and presented statement showing that interest earned by the fund has been credited to it, as recorded on your books.

Your trustee confirms funds on deposit in the amount of $..... which are not sufficient to comply with the provisions of the .....(Indenture)..... We suggest that additional funds in the amount of $..... be deposited with the trustee thereby complying with the provisions of the .....(Indenture) ..... Interest earned on deposited funds is found to be in agreement with the amount recorded on your books.

It appears that no trustee has been provided for a sinking fund, nor have actual funds been set aside to comply with the provisions of the.....(Indenture)..... We suggest that prompt action be taken to comply with the provision contained in the.....(Indenture).....

Prepaid Operating Expenses.—The accounts under this caption represent expenses paid or accrued in the period under review but which are properly applicable to the operations of subsequent periods.

The amounts shown under this caption represent the proportion of expenses, paid or incurred, in the period covered by our examination, chargeable to a subsequent period.

Of the expenses paid or incurred during the period under review we have set up, under this caption, the proportion properly chargeable to subsequent operations.

We examined the insurance policies and found the value carried as "unexpired insurance" to be a correct proportion of the premium paid.

The amount carried for "interest paid in advance" was obtained by prorating discount on notes discounted over the period covered by the notes.

We examined the insurance policies and found the value carried as "unexpired insurance" to be a correct proportion of the premiums paid.

Upon examination of the unexpired insurance policies, we found the balance, as shown on our Statement of Condition, to be correct.

We found the proportion of insurance premiums properly chargeable to subsequent periods to be correctly set forth on the books.

Capital Stock.—Your capital stock records were examined and the amount of outstanding certificates indicated thereon reconciled with the amount shown on our Statement of Condition.

We checked the capital stock certificate stubs and found that the amount of the capital stock issued and outstanding agreed with the Statement of Condition.

We found that the required Federal Tax stamps were affixed to the certificate stubs and canceled.

All certificates turned in for transfer were attached to their respective stubs and properly canceled.

The minute book was scrutinized and found to provide authorization for dividends and salaries paid.

We examined the minute book and found therein proper authority for the payment of dividends and officers' salaries.

Of the authorized capital stock, $..... has never been issued. This is reflected on our Statement of Condition as "unissued stock." We found, however, that the amount is being carried in your books of account as "treasury stock." The latter term is applied to stock which, after being issued for legal consideration, is returned to the treasury by purchase, donation, or otherwise. As the amount of stock mentioned has never been issued, we firmly recommend that it be transferred to an "unissued capital stock" account.

Surplus.—Appended to our Statement of Operations is a reconciliation of the Surplus account as of the beginning and end of the period under review.

The items affecting the Surplus account are detailed in the reconciliation of that account appended to our Statement of Operations.

We have stated in detail, at the end of our Statement of Condition, the items affecting the Surplus account during the period.

By footnotes on our Statement of Condition and Statement of Operations we have called your attention to the fact that the Surplus is subject to a deduction for taxes, for which no reserve had been created. As the amount of tax payable had not been definitely computed at the time of our visit, we

thought it inadvisable to convey a possibly misleading conception of the condition of the business by charging surplus with an estimate of the tax.

Reserves.—The Reserve for Discount on our Statement of Condition was created for the purpose of charging against the profits for the period the probable amount of cash discounts that will be allowed at the time your accounts receivable are liquidated. The creation of this reserve results in more accurately stating the liquidating value of the accounts receivable.

The amount reserved for bad debts appears to be ample to meet possible losses from uncollectible accounts.

The Reserve for Discount was created to take care of probable cash discounts to be taken on accounts receivable. Although the date of remittance for the balances due from trade debtors cannot be foretold, analysis of past collections indicates an average cash discount of.....per centum will be taken. We have accordingly applied that percentage against the amount of accounts receivable in determining the amount to be reserved.

The Reserve for Bad Debts appears to be of sufficient proportions to provide for possible contingent losses from uncollectible accounts. The ratio of Reserve to Accounts Receivable is greater than losses from that direction suffered in the past.

The Reserve for Federal Taxes was created on the basis of the federal taxes for the period as computed by our Tax Service Department.

Our Tax Service Department supplied the amount used in creating the Reserve for Federal Taxes.

The Reserve for Federal Taxes was created on the basis of the tax as computed at the time of our visit. It is subject, however, to any corrections that may be made between that time and the date of filing the return.

The Reserve for Federal Taxes is in agreement with the amount of tax payable as stated on your return filed with the Collector of Internal Revenue.

We examined these accounts and believe them to be adequate to meet any contingency, which may reasonably be expected to occur, in connection with the transactions for the period under review.

The reserve for taxes, other than federal taxes, is based upon last year's tax rates. The amount reserved is the proportion of the estimated tax chargeable to the period under review.

Notes Payable.—No trade paper is included in this amount, the notes representing accommodation extended by your depositaries. Certificates obtained from them verified the accuracy of your records.

By corresponding with the payees listed on your notes payable record we verified the accuracy of the amounts due those creditors.

We corresponded with all noteholders listed on your records and, without exception, received their acknowledgements

that the amounts stated represented the amount of your notes held by them.

A schedule of the notes, as they appear upon your records, accompanies this report.

Our verification of the amount stated as your liability for Notes Payable was limited to a careful check of all entries in your records affecting that account.

The amount of outstanding notes was verified by checking all entries affecting the account and examination of notes paid and canceled. We did not correspond with the recorded holders of your notes for the purpose of verifying outstanding obligations of that nature.

Your record of notes and trade acceptances payable was checked and the total of the outstanding obligations listed therein was found to be in agreement with the balance appearing on our Statement. We did not attempt to verify the items by correspondence.

On Schedule.....we have listed your outstanding notes as they appear upon your records.

According to the information appearing in your records, the following were the notes outstanding as of the date of our statement:

Date Issued	In favor of	Date due	Amount

The following notes were outstanding as of the date of our statement:

Date Issued	In favor of	Date due	Amount

Accounts Payable.—We did not undertake to verify by correspondence the accuracy of the liabilities carried in your open accounts. We scrutinized the balances appearing in the individual accounts and found the total to be in agreement with the control account balance appearing on our Statement of Condition.

The balances appearing in the individual accounts were examined and their total found to agree with the balance in the controlling account listed upon our Statement. We did not attempt verification of the balances by correspondence with the creditors.

The scope of our examination satisfied us that all items included in the inventory for which payment had not been made were properly reflected in this liability.

A listing of all invoices entered in your (charge register —voucher register—accounts payable register) and unpaid at the close of the period agreed in total with the balance carried in the controlling account appearing on our Statement.

We examined the invoices and checked them into the record for proper entry and distribution. We did not undertake to verify the open accounts by correspondence with the creditors, but are satisfied that the amount stated correctly reflects your liability.

We did not correspond with the creditors for the purpose of verifying the amounts due to them on open accounts. The balance shown is that appearing upon your records, the underlying detail of which we thoroughly tested.

Accrued Liabilities.—These items were set up in order that all incurred charges to the operations of the period might be properly included. The entries were examined and found to be correct.

We examined the entries to these accounts and found them to reflect correctly accrued items of expense properly chargeable to the period under review.

General.—We thoroughly examined the detail in the books of original entry, verified the footings and checked the results into the general ledger. The accounts in the ledger were in turn footed and the accuracy established.

All disbursements for the period were carefully examined. Canceled checks supporting the disbursements were checked against the entry in the record and examined for proper endorsement. Pay rolls were examined and thoroughly tested for accuracy of footings. No attempt was made to verify the authenticity of names and amounts entered on the pay rolls.

The canceled checks for the period were checked against the entries in the cash disbursement record and further examined for proper endorsement. We scrutinized the pay rolls and established the accuracy of the footings by thorough tests. The names and amounts appearing on the pay rolls were, however, accepted without an attempt at verification.

Verification of the accuracy of pay rolls is one of the most unsatisfactory tasks confronting a public accountant. The executive must chiefly rely upon the efficacy of a well-devised system of internal checks. The occasional assignment of a

competent employee, in no way connected with the preparation or disbursement of pay rolls, to be present when the pay roll is prepared and disbursed, together with a close follow-up on unclaimed wages, might well merit your attention.

We also made a thorough examination of all disbursements. Canceled checks were matched against their corresponding entries in the cash book and also examined for proper endorsement.

In the course of our examination all books of original entry were checked and footed, the entries then being followed through to the general ledger for verification of correct entry. The general ledger was in turn footed and the accuracy of the accounts thereby established.

The accuracy of your books of accounts was established by examining the entries in the books of original entry, checking them into the general ledger to see that the appropriate accounts were affected and by verifying the accuracy of footings in the ledger and subsidiary records.

We made a detailed examination of the books of original entry and traced the postings of the entries into the general ledger. The accuracy of all footings was established.

We also made a thorough check of the entry of invoices for purchases and expenses. Beyond a cursory examination of each invoice we did not attempt to verify the accuracy of the mathematical computations appearing thereon.

The purchase invoices in your files were checked into the books of original entry, care being taken that the proper accounts were affected.

Invoices supporting purchases and expenses for the period under review were examined and checked into the book of original entry.

The footings in the books of original entry were verified and checked into the respective ledger accounts which in turn were refooted and proved.

We verified the accuracy of the footings in the books of original entry and checked the entries into the general ledger, the accounts in which were later refooted and proved.

In place of the present practice of making entries in the journal without the review and approval of an executive, we recommend that a form of journal voucher be used which would require the review and approval of an executive before entry.

We do not believe that you are getting the maximum of value from your accounting records in the way of monthly statements and reports. Comparative statistics are of inestimable value to a busy executive and we have in mind several that could easily be prepared by your accounting organization. We would be pleased to outline these specifically upon request.

Complimentary Close.—We wish to express our appreciation of the many courtesies extended to our representatives by your executives and office staff during the examination.

Our representatives were extended cheerful assistance and hearty cooperation by your staff during the conduct of the examination.

We found the accounts to be well kept and wish to express our appreciation for the many courtesies extended to our representatives during the period devoted to our examination.

Our representatives again found it a pleasant duty to conduct the examination at your office. We desire to express our appreciation of the courtesies extended to them.

Unusual Business.—The auditor must bear in mind that all classes of business have their own peculiarities. It is impossible in a book of this size to discuss these peculiarities in detail. However, the basic methods of conducting an audit are the same for all classes of business, and before starting the work of an audit the auditor should familiarize himself with those phases of accounting which pertain to the particular business in which the client is engaged.

The audit of banks and brokerage houses affords excellent examples of knowing beforehand what must be done. The auditor must carefully plan the procedure of the audit before starting the work. The first few days in such audits are, of necessity, the most important. The auditor entering a bank or a brokerage house must know immediately what records he should take control of. Hesitancy, through lack of knowledge, or uncertainty of the course to pursue, may render the whole audit useless.

The following pages pertaining to audits of banks and brokerage houses contain suggestions from which the auditor may secure a general outline of what he should look for in such audits.

Section III

BANK EXAMINATIONS

Savings Bank Examinations.—The paragraphs immediately following cover the examination of a savings bank. Like the commercial examination instructions, the details are complete, even to extremes, and though it is best to make so complete an audit if possible, the actual extent of the audit must be determined by the client, the auditor's obligation to the public ending when he truthfully reports upon what he has examined and clearly states the point beyond which he was not allowed to go.

Much that applies to a savings bank examination is also a part of any bank examination. Therefore, we are giving the savings bank formula as an entity, and later add variations to provide for other banks.

General.—A bank audit should be commenced either immediately after or before a day's business, preferably the latter.

The auditor should be prepared to secure and assemble quickly the items to be finally reflected on the Statement of Condition. The assembling of that data may be greatly facilitated by preparing in advance analysis sheets with such designated columnar headings as are necessary for the summarization of the accounts that are to appear on the Statement of Condition. Figures 16 to 56, inclusive, on pages 148 to 174 will be found to contain a few suggested columnar headings generally found to be useful, and which the auditor will find helpful for the delineation of items composing the various accounts prior to their assembly on the Statement of Condition. Obviously the nature of the business done by a bank

will indicate to the auditor the particular headings that will be needed on the analysis sheets, and the forms shown may not be applicable in every instance. They will, however, suggest to the auditor a method of preparing an analysis form best suited to meet the requirements of the examination to be made.

On entering the bank the accountant should at once take possession of the securities, cash, check books, and pass books of depositary banks, and should prepare a Statement of the Condition of the bank as shown by its books.

If any of the securities owned, or held as collateral, are deposited in outside vaults, the accountant should send a written request, approved by an officer of the bank, to the manager of the vaults, that no one be allowed to open the boxes of the bank, without first notifying him. Securities kept in the vaults of the bank, which the accountant cannot examine at once on entering, should be sealed until they can be examined. Until the examination of the securities is finished, all securities, both those which have and those which have not been examined, should be sealed.

No officer or employee of the bank should be allowed to assist in the examination and audit unless so desired by the accountant, who should tell in his statement the extent to which he was assisted by officers or employees.

The accountant should make a complete verification of each item of the assets and liabilities as shown by the general ledger at the date of the audit and the period under examination.

Bonds and Stocks.—The par and book value of all bonds and stocks should be listed from the subsidiary or individual accounts and should agree in total with the proper controlling accounts in the general ledger. The securities should be examined and checked with the par value shown. It should

be ascertained that all unmatured coupons are attached to coupon bonds.

All entries in the general ledger representing bonds, stocks, or notes purchased, paid, or reduced in value should be checked to the general ledger, from the cash book or journal; also with the bill of sale furnished by bankers in connection with such transactions, which should be kept on file in the office of the bank.

The accountant should also be satisfied that the "bearer" bonds exhibited are the property of the bank. This can be ascertained only by insisting that the numbers of the bonds purchased shall be specified in the broker's bill of sale and shall be entered in the individual accounts of the respective issues.

Loans.—Each class of notes, when aggregated, should agree with its controlling account in the general ledger. All partial payments of principal endorsed on the notes, and all new loans taken and old loans paid since the last audit, should be checked with the cash book entries.

In the case of mortgage loans the file should be inspected, to see that the mortgage deeds are on hand, properly signed and recorded, and deeds not in the files of the bank should be accounted for through correspondence or otherwise. The accountant should examine and report on the insurance policies, ascertaining that the amount held is sufficient, has not expired, and is payable to the bank in case of loss. If the accountant so desires he may delegate the examination of mortgage deeds and insurance policies to the members of the auditing committee, and their certificate should be annexed to the accountant's report.

Amounts advanced on construction loans should be verified with the receipts given by the borrower or with the canceled checks given in payment by the banks.

Each borrower on collateral security should be requested,

with the form shown as Figure 49, page 165 to verify the date, rate and amount of note and the collateral which the bank holds. Replies should be sent direct to the auditor's office, and should be carefully checked with the collateral found in the bank.

Bank Accounts.—Each depositary bank should at once be requested to balance the account of the bank and return to the accountant the envelope or pass book, with the canceled checks, together with a certificate from the cashier of the depositary bank showing the balance. With these in his possession, the accountant should reconcile each bank account, and account for items in transit. The dates of deposit credited by the depositary bank should be checked with the records of the bank being examined. It is not sufficient to accept a previous statement of a depositary bank, as proof of the account on the date of the audit.

Real Estate—Banking Purposes.—This account should be examined in the same way as suggested for foreclosed property. If the building is in process of construction or alteration, the contracts and expenditures should be examined. The bank should charge itself with a proper rental for the quarters occupied by it.

Expense Account.—Vouchers for every expenditure should be checked with the entries in the cash book or petty expense book, and then canceled in some form satisfactory to the accountant in order to preclude the possibility of again being entered as vouchers.

Vouchers should be numbered or filed consecutively and items charged to this account should represent only the ordinary expense of conducting the business of the bank.

Other Assets.—Changes in these accounts since the last audit should be investigated. Tax receipts and insurance policies on mortgaged properties should be examined so the

auditor may be assured that the bank's interests are protected. The auditor should ascertain that the premiums on bonds, carried either in bond accounts or in a premium account, are being reduced semiannually to correspond with the declining investment value of bonds.

Cash.—After the cash has been counted all checks found in the cash should, under the direction of the accountant, be deposited for collection, with the request that if any are returned unpaid the collecting bank should notify the accountant. Receipts, memoranda, and items other than checks found in the cash should be listed in detail, and the genuineness and propriety of each established. The cash "over-and-shorts" should be investigated, to determine the propriety of the entries.

Real Estate by Foreclosure and in Possession.—A separate account should be kept with each piece of real estate held by foreclosure or in possession, either in the general ledger or an auxiliary book, and the accountant should satisfy himself that the title thereto is vested in the bank. The accountant should examine not only these accounts, but all the original notes, deeds, etc., and all tax or assessment receipts, which represent assets carried on the books. The income and expenses of foreclosed property should be checked with the cash books and receipted bills, and inquiry should be made as to which estates produce income, and the amount thereof. The assessed values should be obtained and incorporated in the report.

Securities Acquired in Settlement of Indebtedness.—The securities should be examined to ascertain whether any changes in their book value have been made during the period covered by the audit; and if any money has been received from them, either as dividend or interest, or on account of principal, it should be checked to the cash book. Securities of

value not appearing upon the books should be entered thereon at a nominal value as matter of record.

Other Banks.—In national banks and trust companies the same course is followed except that in the cash will be found a greater number of checks which must be traced through the clearing house the following morning. After the examination has commenced and checks that are to clear the next morning are listed, they must remain in the custody of the auditor until delivered, the following forenoon. That is to prevent the substitution of a good check for a bad one, etc. The form of inquiry of the Clearing House banks is shown as Figure 50, on page 166.

Many notes will be found outstanding for collection, and must be verified by mail. The forms to be used and the course to be followed are:

The form shown as Figure 50 also accompanies checks found in the cash, to the Clearing House, a representative of the auditor accompanying the messenger to prevent substitution.

Figure 49 is the form, already referred to, which is sent to all makers of notes, to prove the genuineness of the notes and the correctness of collateral.

The form shown as Figure 51, on page 167, is sent in order to verify open account deposits or certificates of deposit.

Many banks now operate monthly statements. When they are sent out on the last day of the month, and if the examination is made on the same date, check all balances to the ledgers, add ledgers, enclose the form shown as Fig. 9 on page 29 and mail the envelopes personally.

When notes belonging to the banks are sent elsewhere for collection, their existence is verified through the forms which are shown as Figures 52—53, on pages 168-170.

Accounts between banks are checked and reconciled through the use of the form shown as Figures 54—55, on pages 171-173.

Pending physical examination of notes, cash reserves, collateral, etc., all of these evidences should be sealed in packages with the seal shown in Figure 66, on page 224, on the packages and the vault doors. Seals seldom adhere well to the vault door on account of the cold smooth steel surface. Hence the inner wrapping.

A banker and broker has many accounts with customers who have collateral with him. The blank shown as Figure 56, on page 174, should accompany the broker's statement. The latter in turn, must be checked to his books.

INTRODUCTORY LETTER FOR THE CUSTOMARY FINANCIAL EXAMINATION REPORT

Dear Sirs:

In accordance with your request, we have examined the condition of the ..... as of the close of business .....

The results of this examination are presented, attached hereto, together with our comments, in the following exhibits and their accompanying Schedules:

EXHIBIT "1" Statement of condition exclusive of the deferred and accrued items as of the close of business .....

Schedule "A" Securities owned, etc.

EXHIBIT "2" Income and profit and loss account exclusive of deferred and accrued items for period from ..... to close of business .....

Very truly yours,
JOHN BLANK & COMPANY
C. P. A., M. A. I. A.

By .....

New York,
(Date)

THE DEPOSIT NATIONAL BANK

Statement of Condition as of December 10, 19—

ASSETS

	$	$
Loans and Discounts:		
Demand	.....0.00	
Time	.....0.00	
Past Due (Schedule "A")	.....0.00	
Total loans and discounts		.....0.00
Overdrafts (Schedule "B")		.....0.00
Securities owned (Schedule "C")		.....0.00
Banking house property		.....0.00
Other real estate		.....0.00
Furniture and fixtures		.....0.00
Cash:		
In vault	.....0.00	
Cash items	.....0.00	
Items for clearance and collection	.....0.00	
Total Cash		.....0.00
Due from other banks and bankers (Schedule "D")		.....0.00
Federal reserve bank stock		.....0.00
Due from treasurer of the United States:		
Bonds to secure circulation	.....0.00	
Redemption Fund	.....0.00	
Bonds to secure postal savings fund	.....0.00	
Treasury certificates of indebtedness	.....0.00	
Total due from treasurer of the United States		.....0.00
Total assets		$.....0.00

CAPITAL AND LIABILITIES

	$	$
Capital, surplus and undivided profits:		
Capital	.....0.00	
Surplus	.....0.00	
Undivided profits	.....0.00	
Total capital, surplus and undivided profits		.....0.00
Circulation		.....0.00
Due to other banks and bankers (Schedule "E")		.....0.00
Acceptances and bill rediscounted at Federal Reserve Bank		.....0.00
Due to individuals:		
Deposits: Check accounts	.....0.00	
Interest accounts	.....0.00	
Certified checks	.....0.00	
Certificates of deposit	.....0.00	
Cashier's checks	.....0.00	
Postal savings fund	.....0.00	
Total due to individuals		.....0.00
Unpaid dividends		.....0.00
Reserve for taxes		.....0.00
Total capital and liabilities		.....0.00

This statement is subject to our comments upon the examination.

INCOME AND PROFIT AND LOSS ACCOUNT FOR THE PERIOD FROM..... TO.....

(See alternative and commercial form)

	$	$	$
Income:			
Interest received:			
(Classify when possible)	....0.00		
Total Income		.....	
Deductions:			
Interest paid:			
(Classify when possible)	....0.00		
Total Interest Paid		....0.00	
Income for the period before deducting expenses			....0.00
Expenses and General Charges			
Classify		....0.00	
Total Expenses and General Charges			....0.00
Net Income for the Period			....0.00
Balance of Undivided Profits at the Beginning of Period	....0.00		
Add:			
Adjustment items applicable to previous period	....0.00	....0.00	
Deduct:			
Adjustment items applicable to previous period	....0.00	....0.00	
Adjusted Balance Beginning of Period		....0.00	
Dividends		....0.00	
Adjusted Balance after Dividends			....0.00
Undivided Profits (See Exhibit "1")			....0.00

This statement is subject to our comments upon the examination.

RECAPITULATION—CASH, CASH ITEMS, AND EXCHANGES

Teller	*Cash*	*Items*	*Exchanges and Route Collections*	*Difference*	*Total*
	$	$	$	$	$
Control					

FIG. 16

TELLER'S CASH

Cash Held in Vault mark with "VAULT"

Bills	*Gold*	*Silver*
$	$	$

RECAPITULATION

Bills	$
Gold	
Silver	
Cash Items	
Teller's Proof	

FIG. 17

TELLER'S CASH ITEMS

Description	*Amount*	*Remarks*
	$	

FIG. 18

DUE FROM BANKS

Bank	*Amount*	*Statement and Verification Requested*	*Reconciled*	*Received*
	$	$		
Control				

FIG. 19

EXCHANGES

Bank	*Amount* $	*Verification* *Requested*	*Received*

FIG. 20

ROUTE COLLECTIONS

Bank	*Amount* $	*Verification* *Requested*	*Received*

FIG. 21

RECAPITULATION—LOANS AND DISCOUNTS

BALANCE SHEET:

Past Due Discounts
Street Call Loans
Demand Loans Secured
Demand Loans Unsecured
Street Time Loans
Time Loans Secured
Bills Discounted

Control

FIG. 22

BILLS DISCOUNTED—OUT FOR COLLECTION

Date Sent	*No.*	*Maker*	*Maturity*	*Amount* $	*Sent to*	*Verification* *Requested*	*Received*

FIG. 23

DELINQUENT INTEREST DEMAND LOANS

Borrower	*Date of Loan*	*Amount of Loan* $	*Last Interest Paid*	*Time*	*Interest Due Amount* $

FIG. 24

LIABILITY OF DIRECTORS AND OFFICERS

Name	*Title*	*Liability as Maker*	*Endorser*	*Total* $	*Shares of Stock Owned*

FIG. 25

PAST DUE DISCOUNTS

Maker	*Endorser or Collateral (Describe collateral)*	*Maturity*	*Amount* $	*Paid During Exam.*	*Remark*

FIG. 26

DEMAND LOANS—UNSECURED

Date	*Maker*	*Endorser*	*Amount* $

FIG. 27

LOANS SECURED BY COLLATERAL NOT READILY MARKETABLE

Date of Loan	Borrower	Date of Maturity	Amount of Loan $	Description of Collateral

FIG. 28

UNDERMARGINED LOANS

Borrower	Date of Maturity	Amount of Loan $	Description	Collateral Par $	Price $	Market $

FIG. 29

COLLATERAL HELD BY OTHERS

Borrower	Maturity	Amount of Loan $	Description of Collateral	Held By	Held As	Verification Req'std	Verification Rec'd

FIG. 30

EXCEPTIONS—BILLS DISCOUNTED

Maker	Maturity	Amount $	Exceptions	Dispositions

FIG. 31

EXCEPTIONS—COLLATERAL LOANS

Borrower	*Maturity*	*Amount of Loan* $	*Exception*	*Disposition*

FIG. 32

INVESTMENTS

BALANCE SHEET:

Bonds:	
United States Government	$
State and Municipal	
Land Bank	
Foreign Government and Municipal	
Public Utilities	
Railroad	
Industrial and Miscellaneous	
Stocks:	
Federal Reserve Bank	
Other	
Mortgages:	
Control	

FIG. 33

INVESTMENTS

Description	*Par* $	*Value Book* $	*Market* $	*Price*	*Loc't'n*	*Verification Req'st'd*	*Rec'd*	*Dated*	*Acc'd Int. Time*	*Am't* $

FIG. 34

OVERDRAFTS

Account	*Date of Origin*	*Amount* $	*Paid during Examination* $

FIG. 35

RECAPITULATION—DEPOSITS

BALANCE SHEET:

Demand:
- United States Government
- State
- Municipal
- Individual Accts.
- Due to Banks
- Certificates of Deposit
- Certified Checks
- Cashier's Checks
- Dividend Checks
- Other

Time:
- Special Interest Accts.
- Certificates of Deposit
- Christmas Club
- Others

Control

FIG. 36

RECAPITULATION—INDIVIDUAL DEPOSITS

Ledger No.	*Overdraft*	*Bal.*	*Dr.*	*Cr.*	*Overdraft*	*Bal.*
	$	$	$	$	$	$

Control

FIG. 37

INDIVIDUAL DEPOSITS (FOR BOSTON LEDGERS)

Ledger No.

Overdraft	*Balance*	*Dr.*	*Cr.*	*Overdraft*	*Balance*
	$	$	$	$	$

Control

FIG. 38

GOVERNMENT, STATE, MUNICIPAL DEPOSITS DUE TO BANKS
EARNINGS CARRIED ON INDIVIDUAL LEDGERS

Account	*Amount*	*Statement and Verification Sent*	*Verification Received*
	$		

FIG. 39

GOVERNMENT, STATE, AND MUNICIPAL BANK DEPOSITS ON GENERAL LEDGER

Account	*Amount* $	*Statement or Verification Sent*	*Verification Received*

FIG. 40

CERTIFICATES OF DEPOSIT

Date	*No.*	*In Favor of*	*Maturity*	*Amount* $	*Interest Rate*	*Interest Last Paid*	*Interest Accrued*

FIG. 41

TRAVELERS' CHECKS

Issuing Co.	*Serial Nos.*	*No. of Checks*	*Denomination*	*Amt.* $	*Verification Requested*	*Verification Received*

FIG. 42

UNISSUED LETTERS OF CREDIT

Issuing Company	*Number*	*Amount* $	*Verification Requested*	*Verification Received*
Travelers'				
Commercial				

FIG. 43

INSURANCE AND BOND

Company	*Class*	*Amount* $

FIG. 44

CAPITAL STOCK

Stockholder	*Total No. of Shares*

FIG. 45

OFFICERS' CHECKS

Date	*No.*	*Payee*	*Amount* $

FIG. 46

SPECIAL INTEREST DEPOSITS

Ledger No.	*Listing*

Control

FIG. 47

CERTIFIED CHECKS

				Paid during Examination				
Date	*No.*	*Maker*	*Amount*	*1st day*	*2nd day*	*3rd day*	*4th day*
			$	$	$	$	$

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....19....

.....

.....

Dear Sirs:

We are making an examination of the.....
.....
and find among their assets, drafts or checks upon your institution amounting to $.....

These drafts accompany this letter under our seal, which you are directed to break.

Please advise upon the attached blank if the items aggregating the sum above mentioned are proper charges against you.

Very truly yours,

JOHN BLANK & COMPANY, INC.

By .....

Please furnish the information requested.

.....

.....19....

John Blank & Company, Inc.
New York

Dear Sirs:

Drafts or checks amounting to $.....presented through clearing house with your letter of.....
.....by the .....are proper charges against us.

Very truly yours,

.....

FIG. 50

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....19....

.....

.....

.....

We have been requested by.....
to make a thorough examination of their books and records in behalf of their customers and themselves.

Their records show due.....you at the close of business.....$..... as per the enclosed statement; also that they hold for your account, the securities listed on the statement.

To enable us to complete our examination and to certify to the firm's condition, will you please advise if the amount and securities shown are correct, using the attached blank for that purpose.

Very truly yours,

JOHN BLANK & COMPANY, INC.

By .....

No.....

.....19....

John Blank & Company, Inc.
New York

The statement submitted with your letter bearing No..... is correct.

Very truly yours,

.....

FIG. 51

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

To the Cashier, Treasurer, of the.....

You are respectfully requested to forward, at your earliest convenience, to the undersigned, the information asked for in this circular.

This information is requested solely for the purpose of reconciling the account of the within-named bank with your bank at the date of examination of the former.

An addressed and stamped envelope is enclosed for your reply.

Respectfully,

JOHN BLANK & COMPANY, INC.
By .....

Please give the information requested:
.....

FIG. 52

EXAMINATION OF.....OF.....
AS OF CLOSE OF BUSINESS.....19....

Answers to the following questions are respectfully requested:

1. Did your bank have under discount any bills receivable of the bank named or any on which its official endorsement appeared or for which it was in any other way liable? If so, please furnish a list, giving names and amounts.

.....
.....

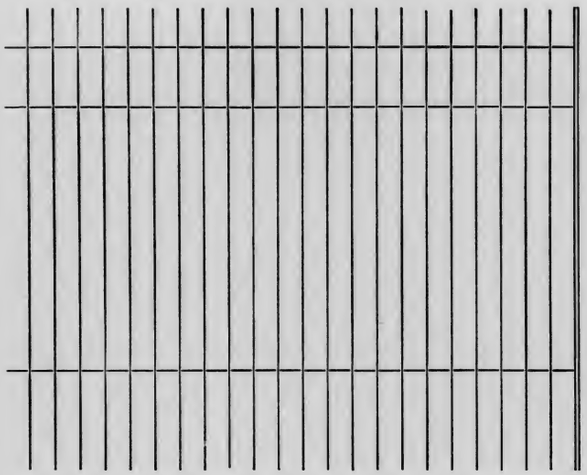
2. Did your bank hold bills receivable or any securities belonging to the bank named, or any on which its official endorsement appeared or for which it was in any other way liable? If any were held, give list and state how they were held.

.....
.....

3. Were there any loans then outstanding by your bank to the bank named, or to any other party for which the bank was in any way liable? If so,

The books of the bank under examination show the following items forwarded to your bank for collection, on the dates given. Please verify this list and attest over your signature below the correctness or incorrectness of same.

Date of Letter of Transmittal	Items Enclosed	Amount Enclosed



Cashier.
.....
Treasurer.

specify character of loan—whether upon bills payable, certificates of deposit, open accounts, or otherwise. In each case specify amount, time, etc.

3. .....
.....

4. Had your bank, at said date, effected any loans for account of the bank named? If so, give names of borrowers and amounts, state how the notes were secured and whether or not the security was held by your bank.

4. .....
.....

5. Please state when your account with the bank named was last reconciled.

5. .....
.....
.....

Cashier.
Treasurer.

Received ....., 19....

FIG. 53

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

To the Cashier,
Treasurer,

You are respectfully requested to forward to the undersigned, at your earliest convenience, the information asked for in this letter.

This information is requested solely for the purpose of reconciling the account of the within-named bank with your bank at the date of the examination of the former.

An addressed and stamped envelope is enclosed for your reply.

Very truly yours,

JOHN BLANK & COMPANY, INC.
By .....

Please give the information requested:

.....

FIG. 54

COPYI

To the Cashier,
Treasurer,

This statement of the account of the.....

rendered at the close of business on.....

.....

found correct with the exceptions (if any) noted below.

DATE					
		We Debit (not in their Account):			
		Remittances in Transit:			
		They Debit (not on our books):			
		Our Balance - - - - Their Balance - - - -			

Please fill out the above blank and also report any counter

NG INK

.....191...

.....

showing a balance of $.....due from the

.....has been examined and

.....Cashier.
Treasurer.

DATE					
		We Credit [not in their Account]:			
		Drafts Issued [Outstanding]:			
		They Credit [not on our books]:			
		Their Balance - - - - Our Balance - - - -			

entries appearing on the statement, not shown on your books

FIG. 55

JOHN BLANK & COMPANY
Incorporated
Auditors and Public Accountants
New York

.....19....
.....
.....
.....

We have been requested by the Board of Directors of the ..... to make a thorough examination of that institution in behalf of the depositors and stockholders.

The bank's records show due you on..... the sum of $.....on..... To enable us to complete our examination and to certify to the condition of the bank, will you please advise if the amount shown is correct, using the attached blank for that purpose?

If incorrect, please advise in detail.

Very truly yours,
JOHN BLANK & COMPANY, INC.
By .....

.....19....

No.....
John Blank & Company, Inc.
New York

Dear Sirs:

The statement submitted with your letter bearing No.....is correct.

Very truly yours,
.....

FIG. 56

TAX REPORTS

Audit engagements may or may not include the preparation of the federal tax return. Where the preparation of the tax return is a part of the audit arrangement and there are no complications due to the volume of business transacted, or previously pending tax situations, the auditor will usually be required to prepare the tax report while making the audit examination. The tax return is then forwarded to the auditor's home office, along with the audit report, where the tax report is given to a tax expert for review before final completion. Every auditor should therefore be familiar with the provisions of the federal income tax regulations. If the tax report is not to be prepared by the auditor during the course of the examination, but is to be prepared at his home office on receipt of the audit report, then it should be remembered that there is considerable data to be shown on the tax return, not ordinarily secured during the course of an audit. The following important items of information are required to complete a tax return. Some of it may be contained in the audit papers. If not, the auditor should be particular to secure the data needed.

CORPORATIONS

Does the corporation report on the basis of a calendar year? If not, when does the fiscal year begin and end?

Correct corporate name and address.

Date of incorporation—laws of what state.

Nature of business.

Profit and Loss statement showing inventories at the beginning and ending of period, classification of expenses, detail of salaries, wages, donations, dividends paid, etc.

Profit or Loss on sale of assets—kind of property, date

acquired, amount received, depreciation previously taken on tax return, cost, value March 1, 1913, if acquired previous thereto, improvements and additions since acquired.

Net profit or loss, and how acquired.

Detail of profit and loss from other than trading operations.

Detail of rents received and paid.

Analysis of interest received and paid.

Analysis of dividends received, name of company, date, amount.

Personnel of corporation's officers: Official title, time devoted to business, detail of stock owned, compensation during the tax period.

Analysis of all taxes paid.

Losses by fire, or other causes,—kind of property, date acquired, age when acquired, cost, probable life after acquirement, depreciation charged off previous year and current year.

Analysis of Surplus account.

Analysis of Investments.

Inventory basis.

Detail of stock owned in affiliated companies.

Bad debts or amount added to reserve.

Secure a copy of last year's return, if not on file at home office.

Partnership

Correct name, address, date organized, date began business.

Name and address of each partner.

How do partners share profits or losses.

Salary paid to each partner.

Analysis of change in capital since last return.

Detail of income from other partnerships, if any.

Other detail—same as for corporation. Secure a copy of previous return, if one is not already on file at the home office.

Individuals

Correct full name and address.

Citizen or resident.

Collector's office at which tax report last filed.

Joint return of husband and wife, or not.

Name of wife, and collector's office at which her return is filed, if separate.

Married and living with husband, or wife, for what period of the taxable year.

Dependents, number and relation of each, and if supporting other persons living in same household, show relationship.

Income—salary—commissions, separately; if tax free interest, show separately.

Profit and loss statement of business, if any.

Analysis of interest and taxes.

Sales of assets, losses, inventory, contributions, etc., same detail as for corporations.

Also secure a copy of previous report if one is not on file.

In all cases where the taxpayer has sustained a loss for the prior year, or two prior years, list a detail of how such losses were sustained, including any deductions not attributable to operation of trade or business, income not derived from the business, dividends received, interest tax free, together with interest paid or accrued and losses not allowable as a deduction.

The schedule of Deduction for Depreciation on a tax return requires more data than is usually contained in the work papers, and in order to complete the tax return at the home office, the auditor should secure a complete analysis of the

Depreciation account in sufficient detail to prepare a comprehensive and intelligent tax return. The schedule of depreciation taken on a tax return requires that the following items be shown:

1. Kind of property
2. Date acquired
3. Age when acquired
4. Probable life after acquirement
5. Cost—exclusive of land
6. Value as of March 1, 1913—exclusive of land
7. Amount of depreciation charged off:
   Previous years
   This year.

The tax form also requires a detailed statement of the reconciliation of Net Income and analysis of changes in Surplus. A proper detail of the data necessary to prepare such a reconciliation is imperative. It should never be treated as a "generality"—the information called for should be definitely ascertained and properly itemized.

The tax form further requires specific answers to certain questions relating to the nature of the business. In order to insure all of the information being obtained, the auditor should have with him a copy of the tax blank, and familiarize himself with the regulations governing its preparation.

SECTION IV

BROKERAGE AUDIT SUGGESTIONS

Brokerage Audits

The following paragraphs are designed to give merely a general outline of the method to be used in examining brokerage accounts. It is assumed that the auditor has a comprehensive knowledge of brokerage technicalities; therefore, no attempt is made to go into all of the detail of accounting methods.

Briefly stated, a stock exchange broker is the person, or firm, engaged in negotiating sales of securities as an agent, and whose income is derived from commissions, interest, etc. The broker is subject to, and must abide by, the rules of the particular stock exchange of which he is a member.

One of the most important operations in the broker's office is the accounting of the business transactions. The regulations of the stock exchange make mandatory the use of certain records which must contain certain information regarding the delivery of securities, and data regarding commissions. These stock exchange regulations, together with the requirements of federal or state laws, have so standardized the required data relating to the buying and selling of securities for customers that the books of brokerage houses are practically uniform. There will generally be found in use the following books:

- Order book
- Purchase and sales book
- Blotter
- Supplementary or general journal
- Margin book
- Customers' ledger
- General ledger
- Private ledger
- Private journal

Stock ledger or securities record
Stocks borrowed and loaned book
Money borrowed and loaned book
Stock transfer register
Vaults list or box book
Revenue tax registers (legally required).

Before starting an audit the auditor must determine definitely the purpose for which it is desired, i.e., (1) is the examination simply the inspection of an individual account? (2) is it going to be for the broker or for a customer? or (3) is it the usual questionnaire audit made in conformity with the requirements of the stock exchange?

Whatever the purpose of the examination, it goes without saying that the audit must be thorough, for the handling and accounting for money and securities calls for the greatest accuracy, and at the same time affords great possibilities for irregularities by speculation, or even misappropriation of the funds entrusted by the customer. Whatever the nature of the audit, the auditor in charge should lay out a working program of procedure, adapted, of course, to the books or combination of books found to be in use.

A Statement of Condition of the average brokerage house will be found to contain some, or all of the accounts noted below. In addition to the accounts enumerated there may be found other accounts, peculiar to the business being audited but whose names will indicate their purpose.

EXHIBIT "1"

.....**COMPANY**

Statement of Condition
as of

.....19....

ASSETS

Cash in Banks and on Hand			
In Banks (Schedule "A")			$0.00
Petty Cash			0.00
Tax Stamps			0.00
Total			0.00
Notes Receivable (Per Schedule "B") ..			0.00
Loans Receivable (Per Schedule "C") ..			0.00
Due from Banks or Bankers:			
Secured and Partly Secured			
Domestic	$0.00		
Foreign	0.00		
Total Secured		0.00	
Unsecured			
Domestic	$0.00		
Foreign	0.00		
Total Unsecured		0.00	
Foreign Currency Accounts—At Market Value		0.00	
Total Due from Banks and Bankers			0.00
Due from Customers and Others:			
Secured and Partly Secured:			
Customers		$0.00	
Partners' Trading Accounts (Schedule			

"D")		0.00	
John Doe (Associate)		0.00	
Employees		0.00	
Total Secured and Partly Secured		$0.00	
Unsecured:			
Customers (Schedule "E")	$0.00		
Employees	0.00		
Total Unsecured		0.00	
Total Due from Customers and Others			0.00
Firm Investment and Trading Accounts			
Long Securities—At Market (Schedule "F")			
Listed on New York Stock Exchange		$0.00	
Listed on New York Curb	$0.00		
Not Listed	0.00	0.00	
Total Market Value of Long Securities			0.00
Syndicate Participation —At Book Value			
A. B. C. Corporation Stock			0.00
Due from Joint Accounts—(Schedule "G")			0.00
Foreign Bonds Deposited as Guarantee			0.00
Foreign Exchange Future Contracts—			
Purchases (Schedule "H")			
Market Value of foreign currencies purchases		$0.00	
Less: Contract value (cost)		0.00	0.00
Due from Foreign Exchange Sold			0.00
Stocks Borrowed			0.00
Failed to Deliver			0.00
Memberships:			
New York Stock Exchange			0.00
Furniture and Fixtures			0.00
Deferred Charges			
Prepaid Insurance			0.00
TOTAL ASSETS			$ 0.00

LIABILITIES AND CAPITAL

Loans Payable			
Loans Secured by Securities:			
Demand Loans			$0.00
Time Loans			0.00
			$ 0.00
Special Loans:			
Itemized			0.00
Total Loans Payable			0.00
Due to Banks and Bankers:			
Free Credit Balances:			
Itemized (Schedule if needed)		$0.00	
Total Due to Banks and Bankers			0.00
Due to Customers and Others			
Free Credit Balances:			
Customers	$0.00		
Partners (Schedule if needed)	0.00		
Associates (List)	0.00		
Employees	0.00		
Accrued Interest	0.00		
Brokerage Payable	0.00		
Dividends Payable	0.00		
Total Due Customers and Others			$0.00
Firm Trading Accounts			
Short Securities—at market value (Schedule if needed)			0.00
Foreign Exchange Future Contracts—			
Market Value of Foreign Currencies Sold (Schedule)		$0.00	
Less: Contract Value (Proceeds)		0.00	
Total			0.00

Due for Foreign Exchange Bought	0.00
Failed to Receive	0.00
Stocks Loaned	0.00
Total Liabilities	0.00
Reserves:	
(Listed)	0.00
Capital	
Partners' Capital Accounts	0.00
TOTAL LIABILITIES, RESERVES AND CAPITAL...	0.00

Another form of Statement of Condition for use with the questionnaire audits required by the New York Stock Exchange is shown below. It is more properly called an Equity Statement of Condition and reflects the actual market values of the securities instead of their actual cost and sales values which are shown on the Statement of Condition as per the books. As in the preceding form no attempt has been made to list all of the accounts peculiar to brokerage audits, but simply to show the more important ones.

EXHIBIT "2"

.....COMPANY

Statement of Condition
as of

.....19....

As at the close of business on this date the assets consisted of the following:

Cash on Hand and in Banks		$0.00
Securities on Hand and pledged as collateral		
(At market values)	$0.00	
Less: Net equity of customers in these securities	0.00	
Total		0.00
Other Assets:		
Exchange Seats	$0.00	
Equity in Partly Secured Accounts....	0.00	
Special Deposits for Syndicates	0.00	
Accrued Interest Receivable	0.00	
Revenue Stamps	0.00	
Collateral Loan Note	0.00	
Unsecured Debit Balances of Customers	0.00	
Recoverable Expense	0.00	
Salesmen's Advances	0.00	
Items in Suspense	0.00	
Total Other Assets		0.00
Total Assets		$0.00

As at the same date the Liabilities were as follows:

Loans Payable		$0.00
Customers' Free Credit Balances		0.00
Customers' Equity in Short Accounts		0.00
Other Liabilities:		
Equities in Syndicate Participations and in Joint Accounts	$0.00	
Interest Due Banks	0.00	
Dividends and Coupons	0.00	
Stocks Borrowed and Stocks Loaned..	0.00	
Margin on ———— Contracts	0.00	
Total Other Liabilities	0.00	
Total Liabilities		$0.00

Balance	$0.00
Deduct Partners' Debit Balances	0.00
Net Worth	$0.00

NET WORTH is represented in the accounts by:

Cash Capital of the Partners	$0.00
Reserve Capital of the Partners	0.00
Stock Exchange Seats	0.00
Profit—as per exhibit	0.00
TOTAL NET WORTH	$0.00

Explantory Notes as found necessary

It will frequently be found that the broker desires a more detailed Equity Statement of Condition, i.e., a statement reflecting the debit and credit ledger balances, the long and short market values of securities, and the resulting assets and liabilities constituting the brokers' equity in the various accounts. The form below will be found to be readily adaptable to general use, with such modifications as the nature of the brokerage business requires.

EXHIBIT "3"

.....**COMPANY**

Equity Statement
as of

.....19....

	Ledger Balances		*Market Value of Securities*		*Equity Statement of Condition*	
	Debit	*Credit*	*Long*	*Short*	*Assets*	*Liab.*
Cash in Banks and on hand, and stamps	$0.00	$	$	$	$0.00	$
Clearing Fund, Stock Clearing Corp.	0.00				0.00	
Loans Payable—Banks		0.00				
Value of Collateral				0.00	0.00	
Stocks Borrowed	0.00					
Value of Securities Long.			0.00		0.00	

Failed to Deliver	0.00					
Value of Securities Long.			0.00			0.00
Failed to Receive		0.00				
Value of Securities Short				0.00	0.00	
Securities in Bond and in Transfer				0.00	0.00	
Stock Customers:						
Debit Balances—						
Fully Secured	0.00		0.00			0.00
Partly Secured	0.00		0.00		0.00	
Unsecured	0.00				0.00	
Credit Balances—						
Against Short Sales		0.00		0.00	0.00	
Free		0.00				0.00
Loans Receivable-Secured .	0.00		0.00			0.00
Partners' Trading Accounts:						
Debit Balances—						
Fully Secured	0.00		0.00			0.00
Partly Secured	0.00		0.00		0.00	
Joint Accounts (Listed) ..	0.00				0.00	
Foreign Exchange Customers:						
Advances against (Commodity)	0.00					
Drafts			0.00			
Value of Collateral						0.00
Debit Balances Unsecured.	0.00				0.00	
Free Credit Balances and Margins		0.00				0.00
Money Borrowed against (Commodity) Drafts ..		0.00		0.00	0.00	
Advances to Employees ..	0.00				0.00	
Accrued Interest		0.00				0.00
Sundry Accounts Payable..		0.00				0.00
Commission Bills:						
Stock	0.00				0.00	
Foreign Exchange	0.00				0.00	
Interest Paid in Advance..	0.00				0.00	
Uncollected Dividends	0.00				0.00	
Unclaimed Dividends		0.00				0.00
Memberships:						
Listed—	0.00				0.00	
Suspense	0.00				0.00	
Reserves:						
For Moving Expense		0.00				0.00
For Bad Debts and Contingencies		0.00				0.00
Capital Accounts:						
Cash		0.00				0.00
Securities			0.00			0.00
Profit and Loss for the Period		0.00				0.00
TOTAL CAPITAL AND PROFIT						0.00
Totals	1.00	1.00	2.00	2.00	5.00	5.00

In addition to the Statement of Condition and such schedules as are necessary, there must be prepared a Statement of Operations for the period. Like the Statement of Condition the terminology of the accounts from which income is derived, or for which expenses are incurred, varies to suit the requirements of the firm being examined. A general idea of the set-up and phraseology of a Statement of Operations may be secured from the two forms shown below. The first shows in detail the accounts from which the revenue was derived, or expenses incurred. The second, in more condensed form shows a summary of the operations. The two forms are as prepared for two different kinds of brokerage business and show the accounts in effect at the time the examination was made.

EXHIBIT "2"

.....COMPANY

Statement of Operations

For the Year Ended.....

.....

Earnings—General Department:			
Income from Trading and Investments in Securities:			
Trading Account Sales			$0.00
Securities short Jan. 1, 1927		$0.00	
Less: Securities short Dec. 31, 1927		0.00	0.00
Total Sales and Securities short..			$0.00
Less:			
Trading Account Purchases		$0.00	
Securities Long Jan. 1, 1927	$0.00		
Less: Securities Long. Dec. 31, 1927	0.00	0.00	

Interest at 5% charged on Trading Account Debit Balances	0.00	
Total Purchases and Securities long		0.00
Profit on Trading Account		$0.00
Net Profit on Special Trading Accounts:		
Foreign Securities Account	$0.00	
Other Accounts	0.00	0.00
Net Profit on Joint Accounts		0.00
Net Profit on Syndicate Participations		0.00
Dividends		0.00
Net Income from Trading and Investment in Securities		$0.00
Selling Commissions		0.00
Other Commissions Received	$0.00	
Less: Commissions Paid	0.00	0.00
Interest Received	0.00	
Less: Interest Paid	0.00	0.00
Total Earnings—General Department		$0.00
Expenses—General Department:		
Advertising	0.00	
Accounting Fees	0.00	
Carfares	0.00	
Dinners	0.00	
Dues and Subscriptions	0.00	
Foreign Expenses of: (Listed)	0.00	
Expenses of Foreign Representatives: (Listed)	0.00	
Insurance	0.00	
News Service	0.00	

Postage	0.00	
Rent	0.00	
Salaries (Office)	0.00	
Stationery and Printing	0.00	
Telegrams and Cables	0.00	
Telephones	0.00	
Traveling Expenses	0.00	
Miscellaneous	0.00	
Total Expenses—General Department		$0.00
Net Earnings—General Department.		$0.00
Net Earnings—Other Departments (Itemized as above)		0.00
Total Net Earnings		$0.00
Other Additions:		
Bad Debts Recovered	$0.00	
Tax Refunded	0.00	0.00
Balance		0.00
Other Deductions:		
Addition to Reserve for Depreciation of Furniture and Fixtures	$0.00	
Bad Debts (Listed)	0.00	
Salaries of Partners	0.00	
Total	$0.00	
Interest on Partners' Capital Accounts	0.00	
Total Other Deductions		$0.00
Net Profit for the year Ended Dec. 31,—		$0.00
Credit personal account of ——	$0.00	
Credit personal account of ——	0.00	
Total Profit Distributed		$0.00

(EXHIBIT "2": SUMMARY)

.....COMPANY

Summary Statement of Operations

For the twelve months ended December 31, 19

Income:			
Originating Syndicate	$0.00		
Participating Syndicate	0.00		
Total Syndicates		$0.00	
Commissions		0.00	
Interest—Customers	$0.00		
—Stocks and Bonds	0.00		
—Money Loans	0.00		
—Bank Balances	0.00		
Total Interest		0.00	
Bond Profit and Loss		0.00	
Branch Office—Profit and Loss		0.00	
Total Income			$0.00
Expenses:			
Out of Town Selling Expense	$0.00		
Selling Expense	0.00		
Total Selling Expense		$0.00	
Interest on Money Borrowed		0.00	
General Expense—Branch Office		0.00	
Partners' Drawing Accounts		0.00	
Interest on Capital		0.00	
Stock Profit and Loss		0.00	
Dividend Account		0.00	
Error Account		0.00	
Branch Office—Profit and Loss		0.00	
Difference Account		0.00	
Total Expenses		$0.00	
Reserve Adjustments		0.00	0.00
Undivided Profits—Exhibit "1"			$0.00

Having determined the extent of the audit to be made, and the forms of the statements to be rendered, with their supporting schedules, the auditor should keep constantly in mind the requirements of the regulations of the stock exchange. A transcript of the regulations prescribed by the Committee on Business Conduct of the New York Stock Exchange is reprinted on pages 194-199.

NEW YORK STOCK EXCHANGE

Committee on Business Conduct

Regulations prescribed by the COMMITTEE ON BUSINESS CONDUCT for audit under authority of Chapter XV, Section 2, of the Rules adopted by the Governing Committee pursuant to the Constitution.

A trial balance shall be obtained and securities balanced.

Securities in box shall be verified by physical examination and comparison with record. Securities in transit or transfer shall be verified upon receipt, or by confirmation. Securities in Safe Keeping shall be inspected and checked with the office record and a written confirmation obtained from the owners.

Ledger balances and Securities shall be verified. Written confirmation of the following shall be obtained:

Bank Balances
Money Borrowed and Detail of Collateral
Accounts carried for the firm by other brokers
Details of

Securities Borrowed
Securities Loaned
Failed to Deliver
Failed to Receive
When Issued Contracts
Open Commodity Contracts with other firms

Customers Accounts
Ledger Balance
Securities Long and Short
When Issued Contracts
Open Commodity Contracts

Partners Accounts
Ledger Balance
Securities Long and Short
When Issued Contracts
Open Commodity Contracts

All Other Personal Accounts

NEW YORK STOCK EXCHANGE

Questionnaire for Registered Member Firms

1. **Total Bank Balances.**
   Enter separately, amount of contribution to Clearing Fund of Stock Clearing Corporation, and deposits with Trust Companies to guarantee Cotton Contracts, etc.

2. **Total Money Borrowed, and Total Value of Collateral.**
   Enter separately, accounts carried for your firm by other banking or brokerage houses, showing Debit and Credit money balances and value of securities both Long and Short.
   State Ledger Balances in the following accounts:

   Stock Borrowed,
   Stock Loaned,
   Failed to Deliver,
   Failed to Receive.

3. **Market Value of Negotiable Securities in Box and Transfer Books.**
   Classify as follows:

   Listed on New York Stock Exchange.
   Market value over $5 per share.
   Market value under $5 per share.

Not listed on New York Stock Exchange.
Market value over $5 per share.
Market value under $5 per share.

(Note)—Do not include the value of any securities in "Safe Keeping," nor the value of any securities carried as "long" if paid for in full by customers.

4. **Customers Accounts.** (All personal accounts other than members of the firm.)
   (a) Total Ledger DEBIT BALANCES in Customers Accounts.
   Classify as follows:
   I—Secured (State value of securities).
   II—Partly secured (State value of securities).
   III—Unsecured.
   (b) Total Ledger CREDIT BALANCES in Customers Accounts.
   Classify as follows:
   I—Against market value of short sales of securities. (State value of these short securities.)
   II—Customers' credits as margin on open contracts in grain, cotton and other commodities. (State equity and deficit with these contracts figured at the market.)
   III—Free Credit Balances.

(Note)—Do not include in answers to Question 4 the value of any securities in "Safe Keeping" nor the value of any securities carried as "long" if paid for in full by customers.

5. **Partners Accounts** (including Capital Accounts.)
   Total Debit Balances and Total Credit Balances, also Total Value of Long Securities and Total Value of Short Securities in the following accounts:
   (a) Partners individual accounts.
   (b) Firm investments and trading accounts.
   (c) Underwritings and syndicate participation accounts.
   (d) Capital accounts.

6. **Profit and Loss Accounts.**
   Surplus and Undivided Profits, including balances in Income and Expense accounts (Commission, Interest, Expenses, etc.) which will eventually be closed by journalizing to a Profit and Loss Account.

(Note)—This question may be answered by giving one net amount, specifying debit or credit.

7. **Other Accounts.**
   State details (Ledger Balances and value of securities) of any accounts which have not been included in one of the answers to the above questions, entering each account separately. These accounts will include Exchange Seats, Office Furniture and other Fixed Assets, if carried on the books, Revenue Stamp Account, Dividend Account, etc.

8. **What steps are your firm taking to comply with that part of Chapter XII, Section 4, of the Rules adopted by the Governing Committee pursuant to the Constitution, which declares that—**

"An agreement between a member and a customer * * * * does not justify the member in pledging or loaning more of such securities than is fair and reasonable in view of the indebtedness of said customer to said member."

9. **Contingent Liabilities.**
   Give brief description, in memorandum form, of any Contingent Liabilities of the firm, that are **not included in a ledger account.** Items of this nature may include:
   "When Issued" Contracts.
   (Total commitments of Customers.)
   (Total commitments of Firm and Partners.)
   Accommodation Endorsements.
   Endorsements of Puts and Calls.
   Rediscounted Notes.
   Participation in any proposition subject to future demands.

10. **Partners Accounts in other offices.**
    Have any of the members of your firm individually or collectively, any security or commodity accounts or com-

mitments carried by other banking or brokerage houses, which are not reflected on your books.

If so, state Debit and Credit Balances, Value of Securities long and short, and Equity or Deficit in open commodity contracts.

GENERAL INSTRUCTIONS

DO NOT PLACE YOUR NAME ON THE ANSWERS YOU SUBMIT.

All answers must be prepared as of the same date (of which you have received notice), and be attested by each member of your firm on the form enclosed.

In stating ledger balances, specify debit or credit, and on security valuations state whether long or short.

Retain a copy of your answers and keep all working papers and memoranda covering the answer and the one previous to it, for audit and review.

Send answers by registered mail in enclosed envelope addressed to Committee on Business Conduct, New York Stock Exchange.

The various books of record used by brokerage houses may be described briefly as follows:

Order Book.—This book is for recording orders for the buying or selling of stock or bonds. Entries are made from the original order slips filed with the order department. The record itself should show the date of the order, time it is entered, name of customer, duration of order, number of shares to be bought or sold, date of cancellation if order is canceled before its execution, and the price at which the purchase or sale is made.

Purchase and Sales Book.—Orders, upon their execution, are permanently recorded in the purchase and sales book. It may be either a bound or a loose-leaf book. The book is arranged to record the date of purchase or sale, broker from whom the securities have been purchased or broker to whom the securities have been sold, number of shares involved, description of the securities, price, time the order was executed, and the name of customer who ordered the purchase or sale.

Blotter.—On the blotter is recorded every detail of importance. It serves for posting purposes and at the same time gives valuable business facts. When no other books of original entry are used the blotter may take the place of a combined cash and general journal. Generally, however, all cash transactions are recorded in the "cash blotter," and those transactions relating only to charges and credits are entered in a supplementary or general journal. This separation speeds the accounting, keeps the cash items separate, and affords many other accounting advantages. Alternating blotters are frequently used which afford greatly increased facilities for posting.

Ledgers.—The customers' ledger, general ledger, and private ledger are occasionally combined into one general ledger.

It is, however, not usual. The debit side of the customers' ledger generally provides space for date, explanation, price, and amount. In the amount column the cost of a purchase and the commission are entered as one amount. The credit side of the account provides for a record of the sale of stocks and bonds, delivery of securities to a customer for his account against liquidated balances, and cash payment made on account of margin.

The general ledger contains the usual controlling accounts of the assets and liabilities, together with the proprietor's accounts. The customers' ledgers and private ledger accounts are not included in the general ledger where subsidiary records are maintained.

The private ledger, as its name implies, is a private record of the capital accounts, or other accounts, for the use of the executive staff with controlling accounts in the general ledger.

Stocks Borrowed and Loaned Book.—This book is usually divided into two parts—one for a record of the borrowing transactions and one for a record of the lending transactions. The columns of the stocks borrowed section usually contain provision for the date, from whom borrowed, number of shares, description, price at which borrowed, date of return, and columns for the insertion of interest rates on the stocks borrowed. The stocks long section of the book is similar to the stocks borrowed section with the exception that the second column is designated "to whom loaned." The value of stocks loaned and stocks borrowed should be in agreement with the general ledger accounts of stocks borrowed and stocks loaned.

Money Borrowed and Loaned Book.—A broker borrowing or lending money must necessarily have a record of such transactions, and the book just mentioned is adapted to that purpose. It provides for date of borrowing, amount,

from whom borrowed, collateral given for the loan, interest, and terms of payment. As these loans are usually call loans and as the rate of interest usually varies from day to day, provision is made for the rate changes. It is to be remembered that securities deposited as collateral for a loan are not recorded in the securities ledger, for, even though such securities are in the hands of the broker as pledgee, they are still the property of the pledgor. The control accounts in the general ledger, Money Borrowed and Money Loaned, are supported by the detail of the money borrowed and loaned book.

Stock Guide or Securities Ledger.—(Also Stock Record or Position Card).—Whatever the form of this record the fundamental principle is the same. It is a record for the listing of securities, their place of deposit or other disposition. Usually one sheet is allotted to each security, and the sheets arranged alphabetically. The left side of the record will show customers' holdings, stocks borrowed from brokers, and failed to deliver items. On the opposite side is a record of short sales, stocks which may be loaned or can be used for collateral for bank loans, failed to receive items, securities in transfer offices, in the vault, or held for safekeeping only.

Margin Book.—In whatever form this record is kept it should instantly show the status of customers' accounts. This book is one of the broker's most closely watched records. It should show the name of the account, number of shares long or short with their description, net price (commission included), market price of the stocks, the margin deposit, and the margin to carry commitments.

Stock Transfer Register.—For the purpose of maintaining a record of the stock deposited for reregistration, or of bonds forwarded to a corporation for changing their form, the stock transfer register is used. Its use affords the broker complete control over all securities in his possession. The record

should show the complete nature of the transaction. It will be found to contain columns for recording the date of deposit, number of shares or par value of bonds, or both, name of the bonds, numbers of the certificates or bonds, name under which the securities were registered, etc. Usually within a few days after deposit with the transfer office the new securities are ready. On presentation of receipt issued by the transfer office the new securities are delivered to the broker. In the stock transfer register are then recorded the date received, or date of transfer, number of shares or par value of bonds, or both, name of the securities, serial number of the new issue, etc. This record is maintained in the chronological order of deposit on the right-hand page, and withdrawal on the left-hand page, indicating at a glance what had been deposited and what has been withdrawn. In verifying this record reference should be made to the Securities Record, recording the income and outgo of securities each day.

Vaults List or Box Book.—Securities in the possession of a broker are of one of two classes: (a) those belonging to a customer on which there is no lien, and (b) those against which there is a debit balance owed by the customer. The former, by law, must be kept separate, for the benefit of the broker's customers. Such securities are oftentimes referred to as "in depot," and a record is maintained to show date of deposit, number of shares, name of stock, name of customer, or owner. When delivered to the owner the date of delivery is recorded.

Securities against which there is a debit balance are kept in the so-called "active box" unless they are pledged for borrowing funds, as it is to be expected that their status will change from day to day. Each day's change must be recorded. A physical count of securities should be in agreement with

the "active" list. Differences found should be immediately traced in order that they may be corrected.

A verification of both the "depot" and "active" records is obtained by checking the box lists against the Securities Record or ledger.

Revenue Tax Registers.—Federal regulations require the affixing of revenue stamps to all securities sold or transferred, and stipulates the form in which records shall be maintained. The regulations of the Internal Revenue Department should be consulted. States also require the affixation of revenue stamps, so the laws of the state in which the brokerage is transacted should be consulted for its provisions.

To maintain a proper record of the use of revenue stamps the Revenue Tax Register is used. It provides a historical record of the sale or transfer of stock, and acts as an inventory record of the revenue stamps on hand. Adding the amount of stamps used to the physical inventory will reflect the amount charged to the Revenue Stamps account in the general ledger at the beginning of the period. Most brokerage houses find it desirable to keep in separate envelopes the several denominations of stamps.

Having determined the forms in use and the scope of the examination to be made, the auditor may plan his examination. It would be difficult to prepare a standard form of program that would be usable in its entirety for every brokerage examination. The regulations of the stock exchange indicate very concisely what is required in the report to be rendered.

The first important thing is the count of securities. They must be counted before the position has changed. Security boxes must be sealed before the count is started. A form of

seal is shown on page 223. This seal must only be broken by responsible persons delegated by the auditor in charge. Proper use of seals will prevent the substitution of securities, or their sale or transfer, before being counted. The possibility of the position changing is a hazard which the auditor must carefully watch, for if the control of the count is lost, the audit becomes of little value, and to secure the correct count will entail great expense. Securities not under seal, or received after the count is started and before it is finished, should be held by the broker as "on hand." If it is found necessary to remove a security under seal the auditor should break the seal, note the change on the verification letter, and reseal the box. This refers particularly to securities in "vault."

Examination of bonds should verify the fact that all coupons are intact, if the coupon form is used, and that coupons used during the period of the audit have been properly accounted for. If the bonds are registered the auditor should be particular to make a careful scrutiny of the interest payments during the period, or pending as of the date of examination and completion thereof.

The second step, which is equally as important as the first, is to send out request for confirmation of:

Failed to receive	Items in transit
Failed to deliver	Stocks borrowed
Bank loans	Stocks loaned.
Transfers	When issued
	Open commodity contracts

Accepted practice is to send out these confirmations immediately after, or before, a day's business. Transfer confirmations need not be sent out if verified upon receipt. All others should be in the mail the morning following the date on which the examination is to be made. Failure to do this

results in adverse criticism on the part of the recipients as later transactions will have gotten on their records.

The auditor may now confine his attention to sending out forms for customers' verification. Many otherwise first-class brokerage audits are muddled by a wrong address being put on the envelope to the customer. This results in undue delay.

Sometimes the customers' address is given in the care of some member of the brokerage firm being audited and the question arises as to whether such requests for verification should be mailed or delivered to the person named in the brokerage office. Despite assertions to the contrary, it is deemed better to mail such verifications, as, having passed through the mails, they are given a legal status of having been received by the proper person.

As soon as the day's postings have been made on the stock guide, a transcript of the guide must be made on a form similar to that shown on Fig. 57. There should be a sheet for each security shown in the stock guide. After completing this work, the auditor has an exact duplicate of the client's stock guide and can proceed checking the securities to this transcript without further delay in the routine of the office.

In most brokerage audits, the customers' verification forms are not ready to be typed the first night, but in the meanwhile the auditor can check all positions but the customers'. As shown on the appended brokerage forms, all verifications are made out in duplicate, the auditor keeping the duplicate copy as his record.

It is absolutely essential that the count of securities be checked to the transcript of the stock guide before the next business day, because any differences between the count and the guide must be adjusted before releasing the boxes and the client will be pressing for early release of the boxes so that

delivery may be made. After the count of securities has been checked in this manner, the auditor may check all other positions to his transcript, using the copies of verifications sent out as a basis. At a later period, when duplicate copies of customers' verifications are at hand, the securities on these should also be checked to the transcript and any differences traced.

It should be borne in mind that the stock guide transcript is the auditor's most important record, since it contains details of all securities' positions. After all positions have been checked thereto, the transcript should be inspected to see that both sides (longs and shorts) are in agreement. Any changes that have been made should also be made on the client's original stock guide. The market price of each security should then be entered on the transcript, whether listed on the New York Stock Exchange or not.

The rules of the Stock Exchange specify that no fully paid or "safekeeping" securities should be used as collateral, or in other words, priced. The next move, therefore, will be to eliminate all such securities on the transcript. This is done by going through the customers' duplicate verification, Fig. 65, and pricing enough securities to give him sufficient collateral to more than cover his debit balance. After doing this the remaining customers' securities should be marked "SK" on the transcript. Of course, all securities of customers having no money balance or a free credit balance should be put in "safekeeping." The ideal situation is that all "safekeeping" securities should be either in the box or in transfer, but if they are not in either place, they should be priced and discussed with the client.

After completion of this work, during which all safekeeping securities are so marked on both sides of the transcript, the auditor should extend the values of each open item on

both sides of the transcript, and the totals of each side as to values should agree.

It is now obvious that by running tapes of the various classes there can be ascertained the total market values of securities. This is done by taking a tape of, for instance, all "Fail to Deliver" values and continuing until tapes are taken of all classifications. These values are then ready to enter on the questionnaire.

As already mentioned, it is difficult to outline a program to conform to all brokerage audits; however, the program shown below has been found satisfactory and, with such additions or subtractions as the audit may justify, will reflect a general procedure.

1. At least one day before date of examination have vault verification forms prepared from open items on card index. If the brokerage house has more than one office, verifications from each office should have a designating office mark.

When verification letters are prepared count the vault securities, checking item for item to triplicate copy of verification letter.

Vault count and verifications should be completed the night preceding the examination date. When count of vault is completed boxes should be sealed, and cashier instructed to hold other securities as "on hand" until after examination. When necessary to remove a vault security the auditor should delegate one of his assistants to break the seal, note a record of the change, and reseal the box.

2. Obtain from the cashier a list of all stocks and bonds on hand, checking count of box securities to list supplied by the cashier.

3. Send out miscellaneous confirmations.

4. When the closing day's postings are made on stock guides, make a transcript thereof.

When making a transcript of stock guides carefully check items taken off to facilitate a recheck for discrepancies.

5. Type verifications directly from customers' ledgers, being careful to check items taken off. Keep separately the verifications for each ledger.

6. Secure from the bookkeepper a trial balance in detail of all of customers' ledgers.

7. This trial balance will show name and amount of money balance. If an account is long or short securities with no money balance, list name and mark 0.00 in money column.

8. Foot trial balances, compare with ledger controls, and check money, item for item, with verifications.

9. Number accounts on trial balance, placing corresponding number on verification letter.

10. Check transcript of "stock guide" (item 4) to customers' verification letters, checking item for item, using check mark, "clearing" security detail on verification letters, and "clearing" transcript of positions, changing letters or transcript positions as discrepancies appear and are traced for correction.

11. Verifications should not be held until positions are completely checked to copy. As soon as all verifications are typed, and checked back to their respective ledgers, mail the verifications. It is a good plan to arrange verifications for customers, vault (safekeeping), and margin alphabetically. Where there is more than one verification, say, a vault verification and a margin verification, addressed to the same person, mail them *in one envelope.*

12. In obtaining addresses some accounts may be designated as "non-mailing customer." Do not mail verifications to such customers without the approval of some member of the brokerage firm.

13. Obtain prices of securities, price and extend transcript of stock guide.

14. Check customers' and brokers' verifications, noting if debit balances are fully secured, partly secured, or unsecured, also whether credit balances are "free credits" or apply against short securities. Securities carried in customers' accounts although fully paid should be carried in safekeeping.

For the purpose of a stock exchange questionaire, analyze money balances obtained from above information into:

Dr.	Fully secured Partly Secured Unsecured	Cr.	Free Short

Reconcile the analysis with the control accounts.

The margin accounts should be carefully checked for any items not fully secured. If there are any, list the money balances with detail of collateral security. So long as the security value is fully equal to the debit balance the account is fully secured, even though the usual normal margin does not prevail. A note should be made, however, of "insufficient normal margins" with supporting detail.

15. When submitting a branch office list of partly secured and unsecured customers' debit balances, the list or schedule should tie up with the customers' analysis as mentioned in item 14.

16. Check the list of counted securities on hand to "on hand" as shown by the position cards. Differences should be reconciled to "in transfer." Make a list of items in transfer, noting name of security, name and address of transfer agent, number of shares or amount of bonds and certificate numbers.

17. Where there is more than one office of a brokerage firm, a schedule should be made of the securities received the next morning after the closing date. As such securities were presumably not included in the closing date count of the office from which sent, and received too late to be included in the count of the office to which sent, they should be listed as "in transit" after verification by actual count, and included by the office to which sent as "on hand" as of the previous day—the date of examination.

The position of securities as between two or more branch offices should be reconciled, differences being taken up and corrected by the controlling office. "Fails to receive" or "Fails to deliver" should be adjusted in figures for the questionnaire.

18. In instances as described in item 17 it is a good plan to secure a copy of the transmittal letter, and also to have each of the offices verify the fact that they have not "doubled" on the count of securities.

19. As of the date of the examination it should be noted if the bookkeeper has closed all profits out of office investment accounts (usually lettered or numbered accounts). The bookkeeper should also furnish a trial balance of those accounts, showing security name, number of shares, or par of bonds, and money balance.

The auditor should check money balance to controls, check long or short securities to position transcripts, segregate short securities and credit balances to cover such shorts instead of showing net money balances as on control. However, if there are longs and shorts of the same security in an account, merely show the net money balance.

20. When checking out position cards to ledgers (or carbon of verification) differences will undoubtedly occur as a result of items not having been properly extended on ledger, incorrect on position cards, or errors in taking off abstract of account for verification letters. These differences must be located, after which correct the copy of verification letter, and if verification has been mailed, a second one should be sent to customer marked "corrected statement." The corrected position cards should be the basis for transcription of any further records, and the corrections carried through to all records affected.

21. Secure a general trial balance, after closing out of profits in office accounts, and check all controls to the trial balance thus taken.

Having verified the securities, the customers' accounts, and gotten the verifications in the mail, the auditor may then give attention to the items which will appear on the Statement of Condition. The previous remarks as to programming work have related to the order, so far as possible, in which the audit should be performed to secure a verification of the figures to be finally shown on the Statement of Condition. In assembling the figures on the Statement of Condition reference should be made to the Regulations prescribed by the New York Stock Exchange, shown on pages 194-198. Having assembled

these figures, they should be carefully scrutinized as to values which the progress of the examination should have developed. Oftentimes many accounts will be passed lightly over, whereas their own designation, to say nothing of their composition, should cause a careful analysis as to actual value. The examination made should have verified the accuracy of the figures, while the scrutiny given to the accounts as they are finally recorded on the Statement of Condition should indicate the merit of the account itself.

Bank balances should have been verified by correspondence with the depositaries. All cash and stamps on hand should have been counted.

Money borrowed on collateral should be confirmed by correspondence with the lender. Such verification should show the amount of the loan, its tenure, rates of interest, and a description of the collateral given for the loan. Similarly, loans made by the client should be verified, attention being given to the sufficiency of collateral on deposit with the client.

Accounts carried for the firm by other brokers should be proven by correspondence with the brokers by whom carried. The auditor's analysis should also determine the actual dollars and cents value of such accounts as at the date of the examination, with such supporting details as the analysis justifies.

Written confirmation of the details of Securities Borrowed, Securities Loaned, Failed to Deliver, Failed to Receive, When Issued Contracts, and Open Commodity Contracts with other firms, should be obtained. Verification of the Securities Borrowed should include the name of lender, number of shares, description, the prices and rates at which the loan is incurred; that for Securities Loaned, name of borrower, number of shares and description of the security, with prices and rates at which the loan was made. Confirmation of the Fails to Receive and Fails to Deliver should show

name of firm from or to whom the securities were to be received or delivered, date, description, price, amount, with necessary remarks to make the transaction clear to avoid duplication of accounts. When Issued Contracts and Open Commodity Contracts should be verified by correspondence with such supporting detail as will leave no doubt as to what the transactions represent. Money value of When Issued Contracts, quantities and money values of Open Commodity Contracts are required to ascertain the merit of the account.

Written confirmation is required for the Ledger Balance, Securities Long and Short, When Issued Contracts, and Open Commodity Contracts, for Customers' accounts, Partners' accounts, and all other Personal accounts.

Printed forms are provided for the securing of the verification of the various accounts. On the following pages are samples of the forms which have been found useful for such purposes.

In addition to the verification of accounts through the medium of correspondence the auditor should give due consideration to the depreciation or appreciation of securities, depreciation of furniture and fixtures and other assets of depreciable nature to determine that capital assets have not been erroneously charged to income.

It will occasionally be found that brokers own their building, on which local taxes must be paid, and depreciation properly determined.

Dividends received, or to be received, on long stocks, require thoughtful consideration, as do also dividends on even stocks—i.e., long and short on the same security during dividend period. Attention must be given to the right to dividends, payments for which are pending. Likewise dividends payable, arising from borrowed stock or account of

certificates still held in the client's name after the date of sale, need careful verification.

In assembling the Statement of Operations the auditor must give careful attention to the items which appear thereon. He will need carefully to analyze and verify the Commission account by checking the individual credits and debits, obtainable from the blotter, the purchase and sales books, or similar records found in the client's office. Interest on customers' accounts, and for stock loaned or borrowed, should be carefully checked, as also should be the premiums on the stocks loaned or borrowed. To render an absolute statement of earnings it may be found desirable to request a confirmation of interest on money borrowed or loaned from the lender or borrower. Reserves provided for the depreciation of capital assets, and also for doubtful accounts, should be determined as sufficient, and if any adjustments are required therein the auditor should prepare such adjusting journal entries as are necessary, or deemed to be proper by the client. Membership dues usually present quite an item of expense and their allocation over the period under examination should be determined to be equitable. The same is true of deferred items of whatever nature.

Having given careful attention to the items of profit and loss the auditor will then be confronted with a distribution of the profit or loss to the interested partners of the firm upon the agreed upon basis between the partners, and the adjustment of the capital accounts of the partners at the end of the period under examination in accordance with the distribution of the profits or losses.

Forms found useful in brokerage examinations are shown on pages 214-229.

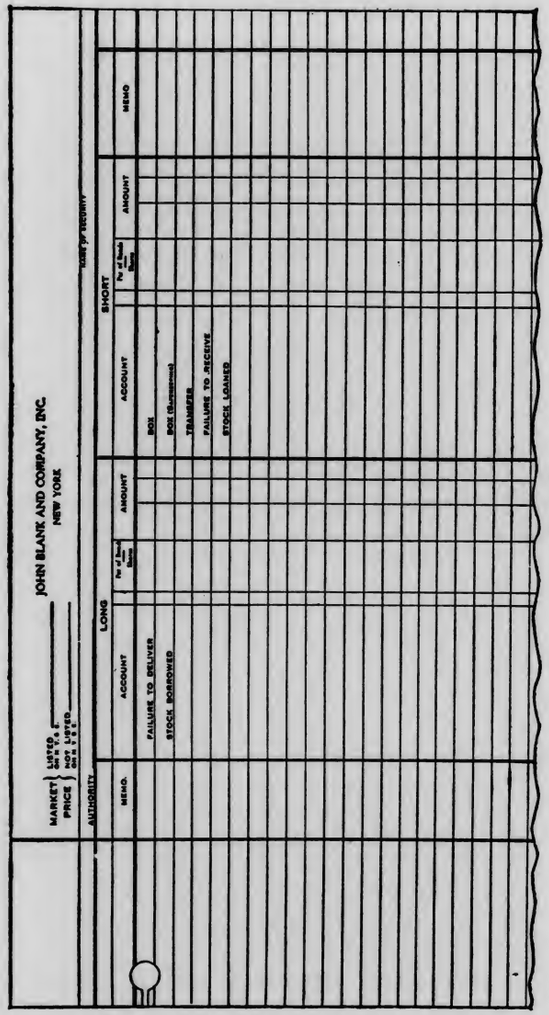


FIG. 57

JOHN BLANK AND COMPANY, INC.
NEW YORK

Dear Sirs:

For use in connection with their periodical audit of our accounts, we shall be obliged if you will please confirm to John Blank and Company, Inc. that the following purchases from / sales to you were pending on a when, as and if issued basis as at the close of business.....

A stamped envelope is enclosed for your reply.

Yours very truly,

DATE	SECURITY	Price per Share	REMARKS

According to our records the above information is correct

Signature.....

DIFFERENCES, IF ANY, SHOULD BE TAKEN UP DIRECTLY WITH THE AUDITORS

FIG. 58

JOHN BLANK AND COMPANY, INC.
NEW YORK

Dear Sirs:

For use in connection with their periodical audit of our accounts, we shall be obliged if you will please confirm to John Blank and Company, Inc. that we were failing to receive from / deliver to you the securities stated hereunder, as at the close of business.....

A stamped envelope is enclosed for your reply.

Yours very truly,

DATE		SECURITY	AMOUNT	

According to our records the above information is correct

Signature.....

DIFFERENCES, IF ANY, SHOULD BE TAKEN UP DIRECTLY WITH THE AUDITORS

FIG. 59

JOHN BLANK AND COMPANY, INC.
NEW YORK

Dear Sirs:

For use in connection with their periodical audit of our accounts, we shall be obliged if you will please confirm to John Blank and Company, Inc. that we were loaning to / borrowing from you the securities stated hereunder, as at the close of business.....

A stamped envelope is enclosed for your reply.

Yours very truly,

DATE		SECURITY	AMOUNT	

According to our records the above information is correct

Signature.....

DIFFERENCES, IF ANY, SHOULD BE TAKEN UP DIRECTLY WITH THE AUDITORS

FIG. 60

JOHN BLANK AND COMPANY, INC.
NEW YORK

Dear Sirs:

For use in connection with their periodical audit of our accounts, we shall be obliged if you will please confirm to John Blank and Company, Inc. that the following items were held by you for Transfer as at the close of business.....

A stamped envelope is enclosed for your reply.

Yours very truly,

NAME OF COMPANY	Class of Stock	Date Presented for Transfer	Ticket Number	Number of Shares	Name to Which Stock is Transferred

According to our records the above information is correct

Signature.....

DIFFERENCES, IF ANY, SHOULD BE TAKEN UP DIRECTLY WITH THE AUDITORS

FIG. 61

JOHN BLANK AND COMPANY, INC.
NEW YORK

Dear Sirs:

For use in connection with their periodical audit of our accounts, we shall be obliged if you will please confirm to John Blank and Company, Inc. that the following $\frac{\text{purchases}}{\text{sales}}$ for your account were pending on a when, as and if issued basis at the close of business.....

A stamped envelope is enclosed for your reply.

Yours very truly,

DATE	SECURITY	Price per Share	REMARKS

According to our records the above information is correct

Signature.....

DIFFERENCES, IF ANY, SHOULD BE TAKEN UP DIRECTLY WITH THE AUDITORS

FIG. 62

JOHN BLANK AND COMPANY, INC.
NEW YORK

Dear Sirs:

For use in connection with their periodical audit of our accounts, we shall be obliged if you will please confirm to John Blank and Company, Inc. that we were borrowing from you in the amount and upon the securities of each loan or loans as described in the attached lists.

If correct, please sign and return the original in the enclosed stamped envelope, retaining the duplicate for your files. If incorrect, please advise us of inaccuracies.

A stamped envelope is enclosed for your reply.

Yours very truly,

FIG. 63

JOHN BLANK AND COMPANY, INC.
NEW YORK

Name of borrower.....

Name of bank.....

Date of loan..... Amount of loan.....

Maturity date ..... Rate.....

Interest accrued and unpaid as at this date, amounting to .....

COLLATERAL

According to our records the above information is correct as at the close of business.....

Signature.....

DIFFERENCES, IF ANY, SHOULD BE TAKEN UP DIRECTLY WITH THE AUDITORS

FIG. 64

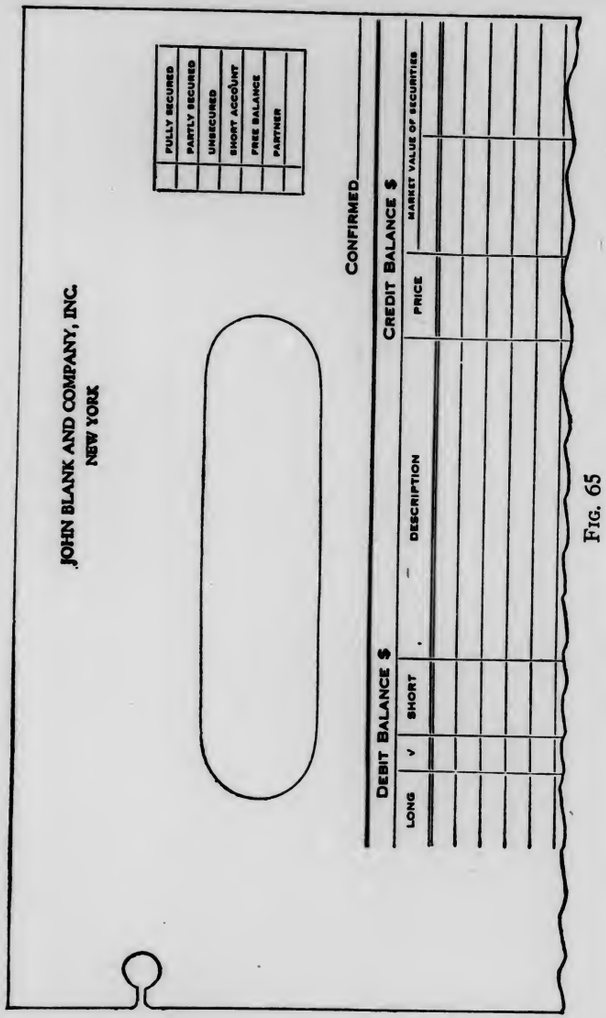

JOHN BLANK AND COMPANY, INC.
NEW YORK
FULLY SECURED
PARTLY SECURED
UNSECURED
SHORT ACCOUNT
FREE BALANCE
PARTNER
CONFIRMED
DEBIT BALANCE $
LONG
V
SHORT
DESCRIPTION
CREDIT BALANCE $
PRICE
MARKET VALUE OF SECURITIES

FIG. 65

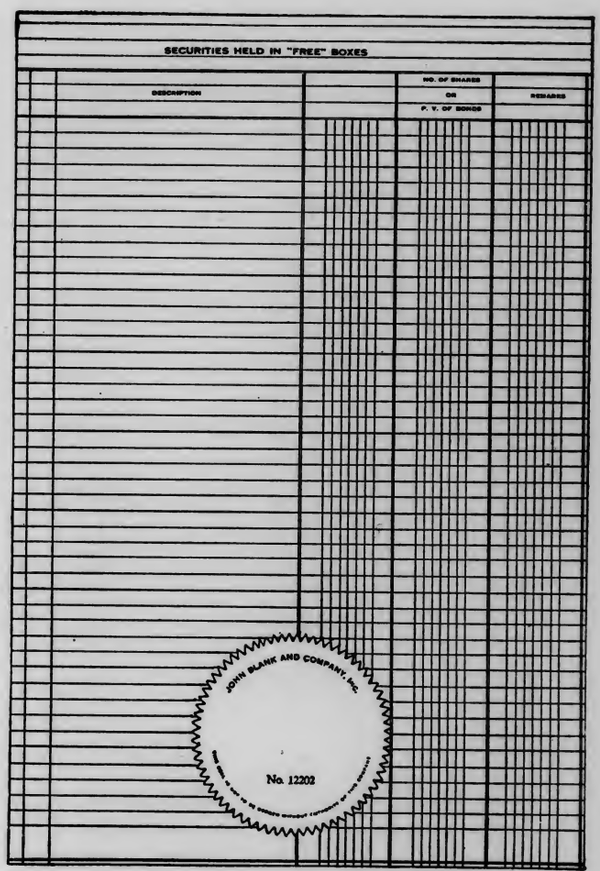

SECURITIES HELD IN "FREE" BOXES
DESCRIPTION
NO. OF SHARES OR P. V. OF BONDS
REMARKS
JOHN BLANK AND COMPANY, INC.
No. 12202

FIG. 66

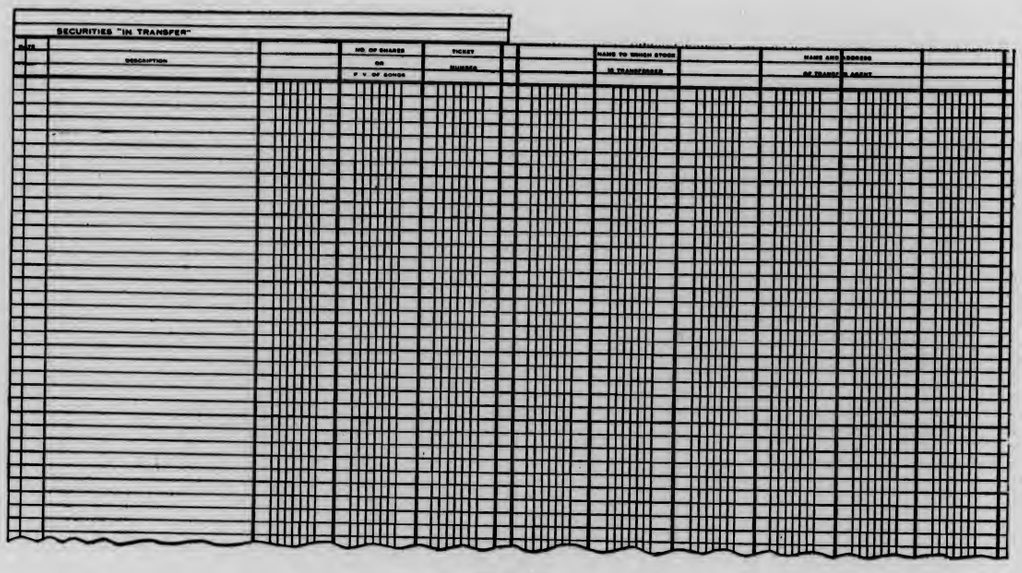

SECURITIES "IN TRANSFER"
DESCRIPTION
NO. OF SHARES OR P. V. OF BONDS
TICKET NUMBER
NAME TO WHICH STOCK IS TRANSFERRED
NAME AND ADDRESS OF TRANSFER AGENT

FIG. 67

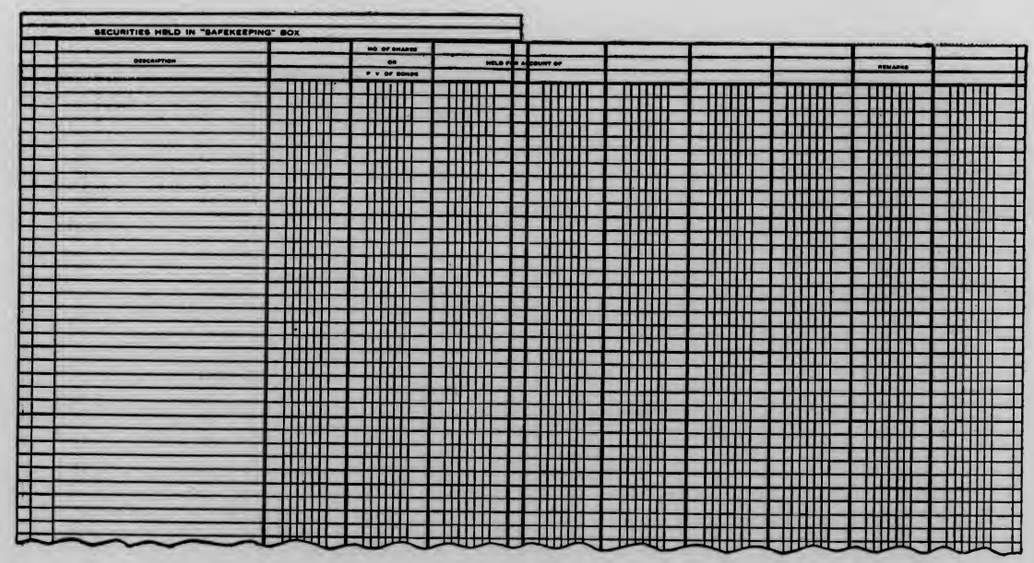

SECURITIES HELD IN "SAFEKEEPING" BOX
DESCRIPTION
NO. OF SHARES OR P. V. OF BONDS
HELD FOR ACCOUNT OF
REMARKS

FIG. 68

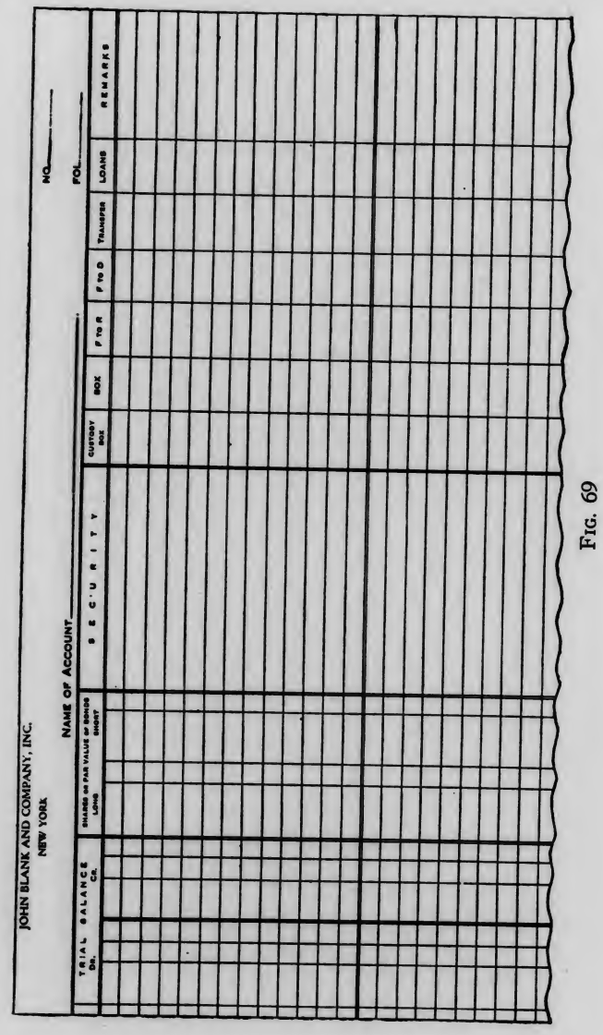


FIG. 69

JOHN BLANK AND COMPANY, INC.
NEW YORK

_____ 19

_____

_____

Dear Sirs:

Our records show that at the close of business _____ we had borrowed from you in the amount and upon the securities described below.

Please confirm this information, and return this form to our auditors in the enclosed addressed envelope.

Yours truly,

_____

DATE ..... RATE ..... MATURITY ..... $ ..... AMOUNT OF LOAN

COLLATERAL

NO. OF SHARES OR PAR VALUE OF BONDS	DESCRIPTION	NO. OF SHARES OR PAR VALUE OF BONDS	DESCRIPTION

The above list agrees with our records. Signed _____

Dated _____ 19 By _____

FIG. 70

JOHN BLANK AND COMPANY, INC.
NEW YORK

_____, 19__.

_____

_____

Dear Sirs:

We are engaged upon an audit of the accounts of _____

and it appears that (at the close of business) on _____, 19__, there was on deposit

with you to his/their credit the sum of $_____

Will you kindly advise us direct whether the aforesaid balance is correct.

Very truly yours,

John Blank and Company, Inc.

By_____

Please furnish the above information as requested.

_____

_____, 19__.

John Blank and Company, Inc.

Dear Sirs:

This is to certify that there was on deposit in this bank (at the close of business) on

_____, 19__, to the credit of _____

the sum of _____ dollars.

$_____ _____

By_____

FIG. 71

_____

JOHN BLANK AND COMPANY, INC.
NEW YORK

_____, 19__.

Below you will find a list of the securities held by _____
in their vault for your account.

After verification, please sign the duplicate copy and return to us. If incorrect please advise in detail.

Please furnish the information requested:

By_____

FIG. 72

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450 M613
Miller, J
How to audit

Fred Montague
DEC 8 1948 598 W 114th
12/27
Aug 29 '51 V. C. Sih
420 W. 206 St. NY
9/17

Date Due

~~Aug 14~~			
~~Dec 12~~			
~~Mar 22~~			
~~Apr 21 '50~~			
~~May 20~~			
~~Oct 19~~			
~~Aug 7~~			
~~July 12~~			
~~JUN 30~~	1947	7/14	
~~DEC 3~~	1948	12/22	
~~Aug 29 '51~~		9/12	

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